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Politics this week

Sep 20th 2007
From The Economist print edition

The American secretary of state, Condoleezza Rice, flew to the Middle East for talks with **Israeli** and **Palestinian** leaders in the run-up to a meeting in New York where representatives of the Quartet—the United States, the United Nations, the European Union and Russia—are to discuss how to reinvigorate the Israel-Palestine peace process.

The Israeli prime minister, Ehud Olmert, declared the **Gaza Strip**, which is controlled by Hamas, an "enemy entity" and said it would be deprived of electricity, among other things, in an effort to stop Gazan militants firing home-made rockets at Israel. See article

Iraq's prime minister, Nuri al-Maliki, said that the American embassy in Baghdad should stop using Blackwater, an American security firm, whose employees had apparently killed 11 civilians after mortar rounds landed near an embassy convoy being escorted through the city. Some Iraqis complained about the immunity enjoyed by the 25,000-plus private security contractors working in Iraq. See article

An anti-Syrian **Lebanese** member of parliament, Antoine Ghanem, was blown up by a car-bomb in Beirut a week before parliament was due to elect a new president. He was the eighth prominent anti-Syrian to have been killed in Lebanon since 2005. The Syrian government denies responsibility for the deaths.

Floods across Africa made at least 1m people homeless, with Uganda and Ghana the worst affected. The UN said that another 15 countries were badly hit. The torrential rains even fell on the desert nations of Mali, Mauritania and Niger.

In its first formal agreement with the ruling ZANU-PF party for many years, **Zimbabwe's** opposition backed a bill that might let President Robert Mugabe pick a successor. But, in talks mediated by South Africa, the ruling party agreed to several power-curbing amendments to constitutional changes that Mr Mugabe had proposed.

Britain's prime minister, Gordon Brown, said he would not attend an EU meeting with the **African Union** in December if Mr Mugabe is there.

After the flames

AFP

Greece's centre-right party, New Democracy, narrowly won re-election, securing a four-seat majority in parliament. But after a strong showing by far-right and far-left parties, Costas Karamanlis, the prime minister, may find it hard to pursue big reforms. See article

Nicolas Sarkozy, **France's** president, announced a series of pension, welfare and labour-market reforms. The most hotly contested will be his pledge to abolish special regimes that pay full pensions on early retirement to certain public-sector workers. See article

Turkey's prime minister, Recep Tayyip Erdogan, said that he wanted to change the law to allow women who wear Muslim headscarves to attend universities. Nervous secular Turks expressed alarm.

A **Swedish cartoonist** who drew a picture of the head of Muhammad on a dog's body went into hiding under police protection after an al-Qaeda leader in Iraq offered a large reward for his murder.

Judicial choice

George Bush asked Michael Mukasey to become America's **attorney-general** following the resignation of Alberto Gonzales. A retired judge, Mr Mukasey has presided over prominent national-security cases, including early proceedings against José Padilla, an al-Qaeda sympathiser. Mr Mukasey's nomination was broadly welcomed by the Democrats, who had promised a fight over some other names that had been floated for the job.

Hillary Clinton unveiled her health-care plan, which centres on a "mandate" compelling Americans to be insured, assisted by an expansion of federal programmes and tax credits for employer-provided schemes. Though ambitious, the presidential candidate's ideas keep the existing health-care system broadly intact, unlike "Hillarycare" in 1993. See article

An **anti-war march** in Washington, DC, resulted in the arrest of more than 190 protesters after minor skirmishes outside the Capitol.

The past catches up

Reuters

Police in **Cambodia** arrested Nuon Chea, the most senior surviving member of the Khmer Rouge regime, responsible for more than a million deaths between 1975 and 1979. He was charged with war crimes and crimes against humanity and will be tried by a UN-backed tribunal.

At least 89 people, most of them foreigners, were killed when an aeroplane skidded off the runway on landing during bad weather at Phuket airport in southern **Thailand**.

The date of **Pakistan's** presidential election was set for October 6th. General Pervez Musharraf indicated he was prepared to relinquish his post as army chief if elected for another five-year term as president. Benazir Bhutto, a former prime minister of Pakistan, has said she will return from exile on October 18th. See article

In **Nepal** the party representing former Maoist insurgents withdrew from the coalition interim government, throwing the peace process into jeopardy and potentially scuttling assembly elections due in November. The Maoists are demanding the immediate abolition of the monarchy. See article

Monks in several cities in **Myanmar** staged protests against the military government. They demanded an apology for the violent quelling of an earlier protest against price rises. See article

Despite protests from Pakistan, India allowed a group of trekkers to visit the disputed **Siachen glacier**, the scene of the world's highest-altitude military stand-off and, in Indian eyes, a potential adventure-holiday spot.

Overdue

After long debate, **Mexico's** Congress approved tax and electoral reforms, a victory for President Felipe Calderón. See article

In an unofficial referendum, residents in three districts in northern Peru voted against a planned $1.3 billion **copper mine** to be developed by a Chinese company. See article

Venezuela's president, Hugo Chávez, threatened to take over private schools that refused to submit to government inspection and implement a new, socialist curriculum.

Reuters

Yale University agreed to hand back to Peru hundreds of artefacts from **Machu Picchu**, the Inca site rediscovered by a Yale archaeologist in 1911.

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Business this week

Sep 20th 2007
From The Economist print edition

In an effort to stave off the harm to the economy from falling house prices and the crisis in the credit markets, America's **Federal Reserve** cut the federal funds rate by 50 basis points, to 4.75%, the first cut in four years. It also sliced the discount rate by the same amount. Stockmarkets initially rallied on the news, and companies rushed to raise money. Though the Fed left its future options open, markets anticipated a further rate cut at its next meeting. See article

China's central bank increased interest rates for the fifth time this year in response to surging inflation. The one-year lending rate rose to 7.29%. Investors shrugged it off and China's stockmarkets continued their upward trajectory.

Rocky terrain

The shake-out from the global credit squeeze led to the first run on a British bank for generations. **Northern Rock's** customers rushed to withdraw their savings after the Bank of England offered the mortgage lender emergency funding. The run continued despite assurances that Northern Rock was solvent. It was only halted after the government (eventually) guaranteed all its deposits. See article

The **Bank of England** also loosened the criteria for emergency loans it makes available to banks, which was interpreted as a *volte-face* in its "tough love" approach to dealing with the financial crisis. Mervyn King, the central bank's governor, was lambasted for not intervening sooner, but he told members of parliament that he had been thwarted by a mix of British and European law. See article

Investors pored over the earnings of **Wall Street** banks to see how the credit-market crisis had affected their business. The most keenly studied were those of Goldman Sachs and Bear Stearns; both have recorded big hedge-fund losses. See article

Milberg Weiss, a law firm, said new charges were being brought against it and **Melvyn Weiss**, its co-founder, in a federal investigation into alleged kickbacks paid to plaintiffs in securities class-action lawsuits. William Lerach, who used to work for Milberg Weiss, had earlier pleaded guilty as part of a deal with prosecutors.

NASDAQ and **Borse Dubai** reached a deal in the battle to take over OMX, a Nordic stock-exchange operator. Borse Dubai will take a 19.9% stake in NASDAQ and also buy its 28% stake in the **London Stock Exchange**. NASDAQ will then own OMX.

China Construction Bank raised $7.7 billion in a public offering on the main Shanghai stock exchange. It was China's biggest domestic flotation to date (CCB is also listed in Hong Kong).

European landmarks

A European Union court upheld the antitrust ruling handed down to **Microsoft** by the European Commission in 2004. The court decided that the commission was right to fine Microsoft *euro*497m ($690m) for "bundling" its media player with Windows and for refusing to share data with rivals so they could comply with the operating system's protocols. With technology companies worrying about the ramifications, critics maintain the commission is being overzealous in its approach and will stifle innovation. See article

The European Commission unveiled its proposals to expand **energy-market liberalisation**. It wants gas and electricity companies to "unbundle" their ownership of power grids and pipelines to enhance competition and said foreign firms would have to do the same if they wanted to enter the market, a warning to Russia's Gazprom, which supplies 25% of Europe's gas.

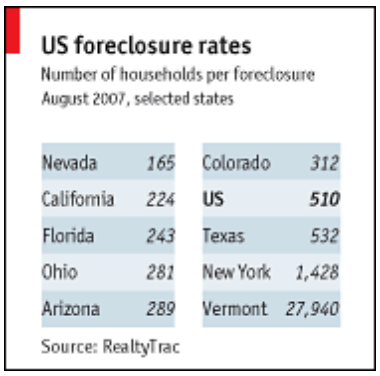
In the latest deal that sees a large mobile-phone operator snapping up a regional provider, Deutsche Telekom's **T-Mobile** USA unit agreed to buy **SunCom Wireless**, which has its business concentrated in America's south-east, for $2.4 billion.

Apple said it would start selling the **iPhone** in Europe in November. As in America, the iPhone will operate with a single network in each country (in Britain it will be O2). Analysts forecast that the device would be a harder sell in Europe given the popularity of cheaper third-generation phones that already have some of the iPhone's features.

Partly in reaction to the Fed's decision on interest rates, **oil prices** reached new peaks above $82 a barrel. **Gold** rose to a 27-year high.

Notice on defaults

Another set of statistics pointed to a worsening situation in America's **housing market**. Among the data, RealtyTrac, an online property firm, reported that home foreclosures had jumped by 36% in August compared with July (and by 115% compared with August 2006). Nevada had the highest rate of foreclosures, followed by California. Vermont had the least.



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KAL's cartoon

Sep 20th 2007
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Illustration by Kevin Kallaugher

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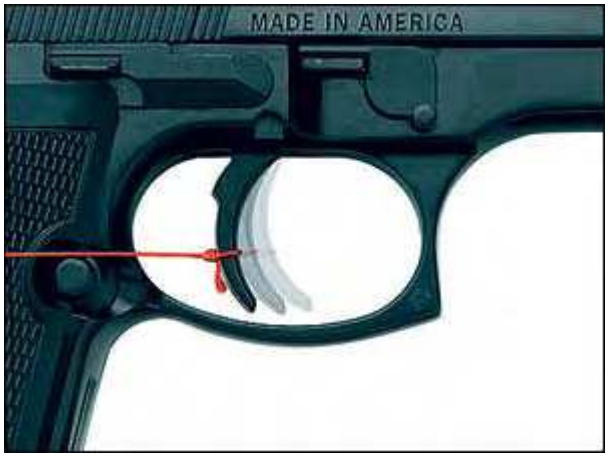
The world economy

Will the credit crisis trigger a downturn?

Sep 20th 2007
From The Economist print edition

Despite the Fed's big interest-rate cut, increasing risk-aversion is likely to depress growth

Corbis



AT THE climax of “The Day the Earth Caught Fire”, a science-fiction film made in 1961, the fate of the planet hangs in the balance. The world's great powers decide to detonate nuclear bombs, hoping to push the Earth off a collision course with the sun. Do they succeed? The final scene shows two versions of the next day's *Daily Express*: the headline on the first reads “World Saved”; the other, “World Doomed”.

In the 2007 sequel, “The Day the Credit Markets Seized Up”, Wall Street seemed this week almost to have made up its mind about the ending: World Saved, Probably. Financial markets had expected the Federal Reserve to cut interest rates by a quarter of a percentage point on September 18th, but prayed fervently for a half. When the half came, America's markets rejoiced: the S&P 500 index enjoyed its largest rise on a single day since January 2003; the next day share prices elsewhere jumped for joy and junk-bond markets sprang back to life.

But on sober appraisal, there is less cause for celebration. Global money markets are still bedevilled by banks' need for cash and mistrust of one another: witness the thousands of Britons who queued this week to take their money out of Northern Rock, a mortgage lender. The longer that money-market rates stay high, the greater the danger that expensive credit will start to hurt real economies. Central bankers still have work to do and reputations to make and lose—chief among them Ben Bernanke, the chairman of the Fed. Mr Bernanke may have been feted this week. But it will take more than one rate cut, with Wall Street and Congress screaming for it, to make his name. In the past the Fed has been too eager to cut rates repeatedly when markets gripe. Mr Bernanke has yet to show he is not making the same mistake.

Reasons to be fearful

The size of the Fed's cut and the statement that accompanied it signified fear more than hope (see article). The central bank hopes to “forestall some of the adverse effects” of the credit crunch on the economy. But trouble may be coming anyway. The housing market's malaise is deepening all the while. This week's symptoms were a 12-year low in housing starts and a doubling of foreclosures in a year. No wonder housebuilders are their gloomiest since the 1991 recession.

If America is set for a sharp slowdown, or even a recession, it is sure to import less from other countries. That, however, is not the main danger to the rest of the world. Both Europe and Asia are less dependent on American growth than they used to be. Europe is now on a par with America as a market for Chinese

exports. Sales to America account for less than 3% of euro-zone GDP. And some rebalancing of the world economy—a smaller American current-account deficit, a weaker dollar—is no bad thing.

The real source of pain is the rise in borrowing costs in both America and Europe. Granted, things are a little better than they were. The gap between three-month interbank rates and Treasury bills, a measure of the risk of lending to other banks rather than Uncle Sam, has narrowed in recent days, helped by the Fed's cut. Sterling interbank rates also fell, notably after the Bank of England abandoned its refusal to intervene in the three-month money market. But the about-turn came only after the panic at Northern Rock—and has heightened criticism of the governor, Mervyn King. Central banks must hope that a turning point has been reached, but interbank rates are still high. There is a long way to go.

From celebration to calibration

A lot of this pain, alas, is necessary. Central banks have been saying for months that risk had become underpriced. Well, now the repricing is at hand, and it is not going to be fun. Banks have to work out the cost of the damage done by years of easy credit and gorging on complicated financial products (see article). It could take months to put prices on the complicated mix of assets for which they are ultimately liable. Meanwhile, they will want to keep cash to themselves rather than lend to others. And in future they may be choosier about who they lend to, directly or indirectly.

This is not to say that securitisation is about to be uninvented. It cannot be and should not be. In recent weeks the dangers of financial innovation—the divorce of originator from ultimate lender; the sheer complexity of some derivatives—have become plain. The benefits remain, not least the increased ability of households to smooth spending over their lifetimes and of markets to allocate risks to those most willing to bear them (see article). But there are cycles in all things: underpricing begets excess, which begets a reckoning. For a while at least, many people and businesses will have to pay more to borrow, or will not be able to borrow at all. The results will be felt in markets for housing—America's was far from the frothiest—as well as junk bonds and corporate buy-outs.

To some extent, easier monetary policy may soothe the transition. Already some central banks have held off interest-rate increases that looked certain a few weeks ago. But even if some of these eventually cut rates, they are unlikely wholly to reverse the tightening of conditions just yet. The markets are in effect raising rates on the central banks' behalf. These monetary policymakers are unlikely to forget inflation in a hurry.

But might the Fed? It says not. And given the recent run of economic data, inflation hardly seems an imminent threat. That ought to help to protect Mr Bernanke from the charge levelled at Alan Greenspan, his predecessor. Under Mr Greenspan, whose memoirs came out this week (see article), the Fed won a name for being quick to cut rates when markets squealed but slow to raise them when the economy picked up. The housing boom—and today's mess—are the result.

Having delivered a half-point cut rather than a quarter, Mr Bernanke is not yet free of the suspicion that he will follow Mr Greenspan's path. Nor is he surely guilty. His Fed has cut rates with the economy looking ropy—but also with bankers and politicians trying to bully him. The hope is that he acted because he saw a gloomy outlook. The fear is that he did so because it is hard for central bankers to say no.

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Britain's bank run

The Bank that failed

Sep 20th 2007
From The Economist print edition

The governor of the Bank of England is the biggest casualty of a financial fiasco—but far from the only one

Landov

Get article background

BRITAIN prides itself on its expertise in finance. The City is the brightest jewel in the economy's crown. Banks and financiers have based themselves in London because of the depth and sophistication of its markets and the sure touch with which they have been regulated.

Until now. The queues that formed outside Northern Rock, the country's fifth-biggest mortgage lender, represented the first bank run in Britain since 1866. The panic was prompted by the very announcement designed to prevent it. Only when the Bank of England said that it would stand by the stricken Northern Rock did depositors start to run for the exit. Attempts by Alistair Darling, the chancellor of the exchequer, to reassure savers served only to lengthen the queues of people outside branches demanding their money. The run did not stop until Mr Darling gave a taxpayer-backed guarantee on September 17th that, for the time being, all the existing deposits at Northern Rock were safe.

No sooner had the queues disappeared than the inquest began. This was the first big test of Britain's monetary and regulatory arrangements since Gordon Brown shook them up within days of arriving at the Treasury in 1997. The Bank of England was given operational independence to set interest rates, but it was stripped of its job as the banking supervisor. That was handed to the Financial Services Authority (FSA). The Treasury, the central bank and the FSA reached an understanding about how they should run the system together.

Until this summer, Mr Brown's reforms seemed to be working well. The Bank of England was lauded for keeping inflation close to the government's target and ensuring a steady expansion of the economy. The FSA won praise for its deft touch, especially in regulating complex financial businesses, which helped bolster the City's appeal as an international centre. But in just a few days a financial storm has blown a hole in the hard-won reputations of the regulator and the central bank. Mr Brown's new system of split responsibility has failed its first big regulatory test.

Northern crock

Mr Darling's guarantee sets a dangerous precedent. It threatens to encourage savers to put their money in high-rate accounts in unsound banks and shareholders to invest in such institutions, comfortable in the

knowledge that the government will be there for them when the going gets rough. But by the time the chancellor acted, he had little choice but to save Northern Rock or risk a disastrous run on other banks.

The mistakes that led up to his move were made long before September 17th. None of those involved comes out well.

Northern Rock deserves censure for its dangerous business model. The mortgage lender, which is based in Newcastle and was formerly a humble building society, had grown too fast, by raising most of its funds from the money markets rather than branch deposits. This left it defenceless against a shortfall in funding when the money markets dried up.

Fault for that lies first with the bank itself, but it also looks as if the FSA was asleep. Sir Callum McCarthy, its chairman, acknowledged this week that Northern Rock's business model was “extreme”. Central bankers had for months been warning about the likelihood of credit tightening. The FSA should have paid attention and discouraged Northern Rock from pursuing its risky strategy.

The FSA's vigilance is crucial, because it is guardian of the public scheme of deposit insurance. Last year, it said this scheme was working just fine. But when tested, the scheme failed: depositors neither understood nor trusted it.

Do you believe in central bankers?

If the FSA and the Treasury come out poorly from all this, the Bank of England emerges worst. At the outset, Mervyn King, its governor, talked tough. Mr King wanted to teach financiers that they should not expect the central bank to bail them out if they took on too much risk. Unlike the European and American central banks, the Bank of England held back from pumping cash into the markets and then did so modestly, insisting on the usual top-notch collateral. It argued that central-bank money could do little to save the three-month interbank lending market, which had gummed up.

The Bank of England's tough line has turned out to be wrong, and events have forced Mr King to relent. On September 19th, the day after the run on Northern Rock had ended, the Bank of England performed a breathtaking *volte-face*. It announced that over the next few weeks it would indeed be providing funds to try to sort out the three-month market. Furthermore, it said that it would lend against riskier collateral, including mortgages.

The charge against Mr King is that his purism turned a crisis into a fiasco. If the Bank of England had acted more promptly to restart seized-up lending markets, his critics say, Northern Rock might have muddled through. No one will ever know whether that is true. Either way, the lurches in the central bank's policy leave Mr King looking either as if he made a mistake, or as if he cannot stand up for his views. Neither characteristic is much sought after in a central banker.

This debacle holds lessons for the way Britain regulates its banks. As Mr King pointed out, defending his performance in front of a House of Commons committee on September 20th, the law prevents the Bank either from staging a covert rescue operation or from engineering a swift takeover; and flaws in the protection of depositors mean that, once an overt rescue operation is under way, depositors will flee. Mr King defended the separation of powers between the Treasury, the Bank and the FSA, but he was wrong to. It has exacerbated the system's flaws: nobody was in charge of the operation.

So why weren't changes made? For that, the people running the system, not the system itself, are to blame.

Nobody trusts politicians. Regulators are always disliked. But central bankers are held to a higher standard; which is why Mr King is the past week's main victim. He has lost credibility; and a central banker without credibility is not much use.

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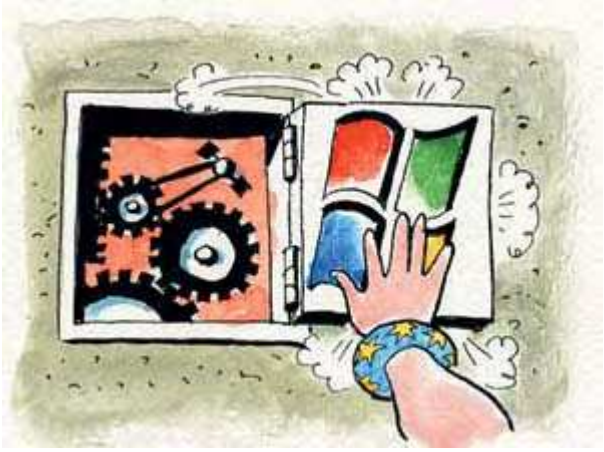
Microsoft

Stay vigilant

Sep 20th 2007
From The Economist print edition

Why regulators should keep their eyes on Microsoft, and others

Illustration by Claudio Munoz



TEN years after Microsoft was dragged before the courts, all its big antitrust cases are back in the news. This week the European Court upheld the European Commission's 2004 decision against the software firm (see article). In a few weeks a judge will decide whether the consent decree in the American case should be extended, keeping Microsoft under close scrutiny. And in South Korea a court will soon rule on whether the firm should unbundle its media-player software from its Windows operating system. But does the Microsoft case really still matter?

Many of those who called for action a decade ago no longer seem to care. Competitors have cut their own deals with Microsoft, extracting nearly $5 billion from the firm, rather than wait for this week's ruling. Microsoft's evil empire has been overshadowed by a newer, and therefore more exciting, threat in the shape of Google. And, geeks point out, the computing world has now become so interconnected that it will be hard for a single company to control it.

There's much in this argument. When Microsoft emerged as the world's most powerful software company, most computers were still stand-alone devices. Now that almost everything is wired and all kinds of services are offered online, machines and software need to be able to interconnect. There is thus a natural tendency towards common technical standards that are not controlled by one company: the internet and its open protocols are the prime example.

Yet the trend towards openness is not inevitable. More than 90% of new personal computers still come with Windows. Microsoft's market share on servers, the computers dishing up data on networks, is increasing, reaching 80% in some markets. So the firm has still the power to extend its monopoly should new technology, at least temporarily, again favour proprietary solutions. And that may be just what's happening now, since software increasingly no longer sits purely on a PC or on a server on the internet, but increasingly works through a complex combination of the two.

New monopolies could still arise in other technological fields, too. One is copy-prevention software, like that which Apple uses on its iTunes music store. Centralised databases become more valuable the bigger they get, potentially locking users in. And as users annotate Google's online maps, the firm may end up with a map and location monopoly.

The ones worth watching

The commission should not take the Microsoft decision as encouragement to jump on every dominant company when competitors complain about it, for firms' grips can loosen as well as tighten. Apple could lose control of online music, for instance, if record labels decide to do away with copy-prevention measures, as some are now doing. But some firms have tighter grips than others—some tight enough to warrant close regulatory attention. One such is Microsoft, which is why the consent decree in America should be extended, as some states are demanding. Another may be Google, which will soon seek the commission's approval of its takeover of DoubleClick, a firm that delivers online advertising. The commission also has Intel and Qualcomm in its sights.

Technological change tends to loosen incumbents' grips. But occasionally it tightens them—which is when the regulators need to be especially vigilant.

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Civil liberties under threat

The real price of freedom

Sep 20th 2007
From The Economist print edition

It is not only on the battlefield where preserving liberty may have to cost many lives

Illustration by Daniel Pudles

"THEY hate our freedoms." So said George Bush in a speech to the American Congress shortly after the attacks on America in September 2001. But how well, at home, have America and the other Western democracies defended those precious freedoms during the "war on terror"?

As we intend to show in a series of articles starting this week (see article), the past six years have seen a steady erosion of civil liberties even in countries that regard themselves as liberty's champions. Arbitrary arrest, indefinite detention without trial, "rendition", suspension of *habeas corpus*, even torture—who would have thought such things possible?

Governments argue that desperate times demand such remedies. They face a murderous new enemy who lurks in the shadows, will stop at nothing and seeks chemical, biological and nuclear weapons. This renders the old rules and freedoms out of date. Besides, does not international humanitarian law provide for the suspension of certain liberties "in times of a public emergency that threatens the life of the nation"?

There is great force in this argument. There is, alas, always force in such arguments. This is how governments through the ages have justified grabbing repressive new powers. During the second world war the democracies spied on their own citizens, imposed censorship and used torture to extract information. America interned its entire Japanese-American population—a decision now seen to have been a cruel mistake.

There are those who see the fight against al-Qaeda as a war like the second world war or the cold war. But the first analogy is wrong and the moral of the second is not the one intended.

A hot, total war like the second world war could not last for decades, so the curtailment of domestic liberties was short-lived. But because nobody knew whether the cold war would ever end (it lasted some 40 years), the democracies chose by and large not to let it change the sort of societies they wanted to be. This was a wise choice not only because of the freedom it bestowed on people in the West during those decades, but also because the West's freedoms became one of the most potent weapons in its struggle against its totalitarian foes.

If the war against terrorism is a war at all, it is like the cold war—one that will last for decades. Although a real threat exists, to let security trump liberty in every case would corrode the civilised world's sense of what it is and wants to be.

When liberals put the case for civil liberties, they sometimes claim that obnoxious measures do not help the fight against terrorism anyway. *The Economist* is liberal but disagrees. We accept that letting secret policemen spy on citizens, detain them without trial and use torture to extract information makes it easier to foil terrorist plots. To eschew such tools is to fight terrorism with one hand tied behind your back. But that—with one hand tied behind their back—is precisely how democracies ought to fight terrorism.

Take torture, arguably the hardest case (and the subject of the first article in our series). A famous thought experiment asks what you would do with a terrorist who knew the location of a ticking nuclear bomb. Logic says you would torture one man to save hundreds of thousands of lives, and so you would. But this a fictional dilemma. In the real world, policemen are seldom sure whether the many (not one)

suspects they want to torture know of any plot, or how many lives might be at stake. All that is certain is that the logic of the ticking bomb leads down a slippery slope where the state is licensed in the name of the greater good to trample on the hard-won rights of any one and therefore all of its citizens.

Human rights are part of what it means to be civilised. Locking up suspected terrorists—and why not potential murderers, rapists and paedophiles, too?—before they commit crimes would probably make society safer. Dozens of plots may have been foiled and thousands of lives saved as a result of some of the unsavoury practices now being employed in the name of fighting terrorism. Dropping such practices in order to preserve freedom may cost many lives. So be it.

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Israel and Palestine

Get a move on, then

Sep 20th 2007
From The Economist print edition

Diplomacy has yet another fleeting chance, if the politicians can be bold

Reuters

FEW people would put much money on the idea that peace is about to engulf Israel and Palestine. The Israeli and Palestinian leaders, Ehud Olmert and Mahmoud Abbas, look weak. One of the two bits of a future Palestinian state, the Gaza Strip, is under the thumb of the Islamists of Hamas and locked out of the diplomacy. The United States, still the only power that can really bang Israeli and Palestinian heads together, has been preoccupied elsewhere. Yet, perhaps precisely because things look so bad in Iraq and the Iranian nuclear conundrum seems so insoluble, the Americans may think another push for peace worthwhile. And about time too.

Everyone knows pretty well what a peace settlement would look like. The two states of Israel and Palestine would be divided by a border that would be close to the one that existed before the war of 1967, and closer to it than the new line being drawn by Israel's barrier now jutting into the West Bank; the Palestinians would have to be compensated, among other things, with swaps of land. Jerusalem would be shared and divided—another tortuous task but not an impossible one. And the far-flung Palestinian diaspora would be free to return to the new state of Palestine but not, bar a few exceptions, to the lands lost in 1948, when the Jewish state came into being in a war that caused the exodus of some 700,000 Arabs.

But how to get there? The latest, still rather vague, plan is for a “declaration of principles” to be agreed upon at a conference in America in November or December. The three big sets of issues—borders, Jerusalem and the Palestinians' right of return—would have to be clarified first, otherwise there would be little point in holding the event at all.

The question is how detailed these principles should be. This week Condoleezza Rice, the American secretary of state, has been in Israel and the West Bank, exploring ideas before a meeting in New York of the Quartet—the United States, the United Nations, the European Union and Russia—that is supposed to forge peace together. Britain's former prime minister, Tony Blair, the Quartet's latest envoy, has been scuttling around the Middle East trying to persuade the Israelis to admit that the states should coincide roughly with the map before 1967 and the Palestinians to admit that a right of return to an Israel within those borders is unfeasible.

To take that historic step, the Palestinian leader, Mr Abbas, would need the protection of nearby Arabs in the region: Egypt, Jordan and particularly the Saudis, who have emerged as the region's busiest power-broker. For his part, Mr Olmert's admission that a two-state map would be based broadly on the 1967 one would lose him a chunk of his fragile coalition and maybe an election if one were forced. Both steps would require huge courage by the two leaders; both may well flunk.

Hamas and its Syrian and Iranian backers may howl treason and plot a return to suicide-bombs. Syria, however, should if possible be drawn into the talks. Efforts should be kept up to persuade Hamas to accept a two-state deal and to stop rockets being fired from Gaza into Israeli towns. As for Israel, suffocating Gaza economically, as the Israelis seem bent on doing, is both cruel and unlikely to help the cause of peace—just as calling the strip “an enemy entity” and threatening to cut off power and fuel is unlikely to stop the rockets.

It is all up in the air (see article). No one is confident. But most Palestinians and most Israelis are as keen as ever for a breakthrough towards a compromise. Another try is due.

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On Belgium, trusting the markets, Google, Amerigo Vespucci, capital punishment

Sep 20th 2007
From The Economist print edition

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Belgian blues

SIR – If, as you suggest, Belgium were to break apart, it would be a victory for nationalism and regionalism in Europe ("Time to call it a day", September 8th). Diversity, respect and understanding cultural differences are the prominent values in Europe today. It is one thing for a region to fight for its cultural identity, but quite another to encourage a rejection of someone else's language and mores (separatism is the agenda of the right-wing Vlaams Belang party in Belgium).

Moreover, Belgium has always consisted of different nations and has dealt with its intrinsic differences in the most pacific way. Not a single drop of blood has been shed for the various causes that are presently shaking the country. The dissolution of Belgium would also encourage those regions in Europe that have sought independence, but which have often pursued their goals with various forms of violence: the Basque country and Corsica spring to mind. Perhaps Belgium has not yet "served its purpose".

Xavier Vanden Bosch
Brussels

SIR – What you did not mention is that the main glue preventing the break-up of Belgium is the status of Brussels. Originally Flemish, but now with a large majority of French speakers and officially bilingual, the Flemish regional parliament, though technically outside Flanders, is situated there. The French-speaking majority of Brussels would rebel against any independence deal that gave the city to Flanders (many of the expatriate residents of Brussels would be delighted however, given how badly the city is run), and Flanders would not tolerate Brussels becoming part of Wallonia or France or an independent city-state.

The Flemish and Walloons are in fact like a married couple who can no longer stand each other and live in separate rooms of the house, but shrink back from divorce in horror at the inevitable bruising fight over the custody of their child, Brussels.

Steve Ryan
Brussels

SIR – I suppose one had to expect our problems would inspire the kind of arrogant contempt that was written in your leader. If Belgians are to blame for their own history, do they really need this kind of advice? But of course, the debate in Belgium, according to you, centres on an absurd monarchy, an unhappy union of its people and colonialism, so we are certainly interested to hear the views of one of Her Majesty's citizens. And thanks for the clichés about *frites* and "a praline divorce". When Scotland departs from that great British union, shall we talk of a pudding divorce?

Jean Pierre Muller
Brussels

SIR – Another article mentions the problems of a "doomed attempt" by the Taiwanese to join the United Nations as "Taiwan" rather than the "Republic of China", the name under which they lost their seat in 1971 ("The trouble with democracy", September 8th). If the praline divorce does happen, couldn't Taiwan join the UN as "Belgium"?

Jerry Rose
Glendale, Arizona

Market trust

SIR – Perhaps being somewhat doltish, I was never able to figure out how a portfolio of junk assembled by someone else was rated less risky than a portfolio of junk assembled directly (Buttonwood, September 8th). A simplistic view perhaps, but that is how the products were explained to me by a salesman. The current turmoil in the financial markets will result in investors focusing their distrust on those fund managers who happily piled into exotic products that they didn't comprehend. But although financial agencies face a difficult few years, regulatory measures are not necessary to re-establish trust.

Investors will accept lumpier returns on risks that they do understand rather than smoothed returns on risks they do not. As my mother told me before I attended the local disco as a teenager: “Only dance with the girls that you know.”

Richard Kidney
Dublin

The benevolence of Google

SIR – Your leader on Google contains an economic contradiction (“Who's afraid of Google?”, September 1st). It is a common misunderstanding that “the main contribution of all companies to society comes from making profits.” Actually, the value to society lies in the work being done by a company, not in its profits. You recognise this when you then say that Google is socially valuable because “it provides a service that others find very useful.”

This view has, of course, been a central tenet of economics since Adam Smith. Profit in most cases (although, alas, not all) is the consequence of doing socially useful work. The anticipation of profit provides the economic stimulus for the work itself.

Lee Preston
College Park, Maryland

A Welsh discovery

SIR – Regarding your book review on Amerigo Vespucci, the explorer, some people dispute the notion that he was “the man who gave his name to America” (“New World disorder”, September 1st). The Americas may actually have been named after Richard Ameryk, a wealthy Welsh merchant who was the main investor in the second transatlantic voyage of John Cabot (Giovanni Caboto in his native Italian). New lands in the late 15th-century were usually named after a person's last name, not the first. If it was Amerigo Vespucci who gave his moniker, America would instead be called, “Vespuccia”.

This does not detract from Vespucci's contributions, but we should rightfully give credit to a Welshman as the person after whom America is named.

Sylvain Fribourg
West Hills, California

Capital offence

SIR – Your briefing on capital punishment in America was permeated with the usual anti-death-penalty claptrap, which no doubt flattered the prejudices of Europeans and some here (“Revenge begins to seem less sweet”, September 1st). For instance, you repeated a staple belief of abolitionists that the death penalty is losing support among Americans. Yet in truth, support for the death penalty in America remains strong.

You should also peruse the FBI's crime statistics for 2005. They show that the murder rate per 100,000 people in the ultra-liberal, abolitionist jurisdiction of Washington, DC, was an eye-popping 35.4, whereas in Texas, peppered with your death-penalty “enthusiasts”, it was 6.2. It appears that the citizens of the good district are vastly more enthusiastic and liberal in meting out the death penalty, albeit privately, than we allegedly trigger-happy Texans.

Peter Plotts

Austin, Texas

SIR – With regard to those who like to refer to the Old Testament in defence of the death penalty, such as the Texan prosecutor you quoted, I seem to recall that the Sixth Commandment instructs: “Thou shalt not kill.” I do not remember it adding, “some exceptions apply.”

Jason Smith
London

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The global economy

The turning point

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Illustration by James Fryer

Does the latest financial crisis signal the end of a golden age of stable growth?

IF ECONOMICS were a children's tale, a long period of rising incomes and improving living standards would always be followed by a big, bad recession. Rising unemployment, falling spending and contracting output—such is the inevitable reckoning for the good times of plentiful jobs and abundant earnings that went before. The hangover needs to be commensurate with the party.

No country has had it quite so good as America. For the past 20 years or more its economy has managed an enviable combination of steady growth and low inflation. To add to its good fortune, spending has routinely exceeded its income—leading to a persistent current-account deficit—without any apparent ill effects on the economy. The occasional setbacks have been remarkably small by historical standards. At the start of 1991, for instance, America's GDP fell for a second successive quarter (a common definition of a recession). But output soon recovered and by the end of the year had surpassed its previous peak. The next downturn, in 2001, was shallower still, with GDP dipping by less than half a percent.

More recently, other rich countries have enjoyed a similar improvement in economic stability. The ups and downs of economic life, known as the business cycle, have provided a much smoother ride than they once did. That is partly why there has been such a clamour for financial and housing assets, and why firms and households have been more willing to take on debt. A lot is now riding on this golden age of stability continuing.

But perceptions about risk are shifting. America's economy, for so long seemingly impregnable, has been growing rather meekly for the past year, weighed down by a slump in housebuilding. The ongoing crisis in credit markets threatens it with recession. Some observers, long mystified by America's ability to live beyond its means and postpone what they see as an unavoidable downturn, think that the world's biggest economy might finally have run out of luck.

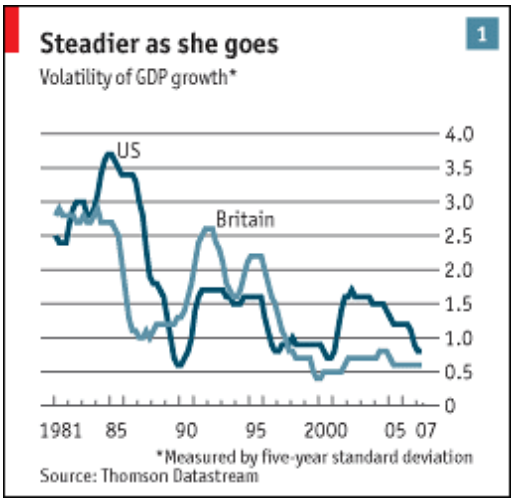
Competing views about what lies ahead are themselves cyclical. When growth is steady, the belief that the business cycle can be tamed is understandably high. When recession threatens, that confidence can quickly vanish. On a pessimistic view the “Great Moderation”—the sharp drop in economic instability in America and other rich countries—will prove illusory. But an optimist would counter that the vast improvement in economic stability has been so marked that it will not just disappear overnight.

The world economy has reached a decisive point. If that magical combination of growth and stability was just luck, it is now due a long-postponed and painful correction. But if it was thanks to changes in the way the world works, does that mean the golden age will endure?

Luck or judgment?

Much of the focus—in good times past, as well as bad times present—has been on America, where fluctuations in economic growth have fallen by around half since the early 1980s (see chart 1). In upswings the economy's growth rate has varied by less from one quarter of the year to the next and from year to year. Recessions have been rarer, shorter and shallower.

The most visible symptom of this smoother trajectory is in the jobs market. Since the mid-1980s, America's unemployment rate has fluctuated far less than it did in earlier generations. Between 1961 and 1983, America's annual unemployment rate varied from 3.5% to 9.7%. Since 1984, it has stayed within the tighter bounds of 4% to 7.5%.



Much of America's good fortune has been repeated elsewhere. A study published last year by Stephen Cecchetti, of Brandeis University, Alfonso Flores-Lagunes, of the University of Arizona, and Stefan Krause, of Emory University, found that 16 out of 25 OECD economies, including Britain, Germany, Spain and Australia, had also seen a marked improvement in economic stability.

What lay behind that change? The sceptical view is that improved stability has no cause: it is mostly down to luck. Economic shocks—abrupt shifts in business conditions—have by chance been less powerful. The economy is no better at taking a hit; it is just that since the two oil-supply shocks of the 1970s the punches have not been so hard.

Yet the global economy has taken some big blows during the golden age. In the last decade the rich world has weathered the Asian financial crisis, Russia's debt default, the dotcom boom and bust, terrorist attacks on America, sharp increases in oil prices and the uncertainty that came with wars in Afghanistan and Iraq. Still, economic volatility has not picked up. It is true that the abrupt curtailment of energy supplies to a world that was highly dependent on oil was a unique and traumatic event. But economies were more hidebound then: job markets were less flexible and producers more stymied by regulation. The painful results cannot wholly be put down to energy dependency.

The flexible economy

The more likely explanation is that economies have become far better at absorbing shocks, because they are more flexible. There are many structural shifts that might have contributed to this, from globalisation to the decline of manufacturing in the rich world. The academic literature keeps returning to three: improvements in managing stocks of goods, the financial innovation that expanded credit markets, and wiser monetary policy.

For such a tiny part of GDP, the content of warehouses has had a surprisingly big effect on its volatility. When industries cut or add stocks according to demand, that adjustment magnifies the effect of the initial change in sales. Stock levels were once much larger relative to the size of the economy, so a small slip in demand could easily blow up into a recession. But thanks to improvements in technology, firms now have timelier and better information about buyers. Speedier market intelligence and production in smaller batches allows firms to match supply to changing conditions. This makes huge stocks unnecessary and minimises the lurches in inventories that were once so destabilising. The entire inventory of some lean-running companies now consists of whatever FedEx or UPS is shipping on their account.

Mr Cecchetti and his colleagues calculate that, on average, more than half the improvement in the stability of economic growth in the countries they studied is accounted for by diminished inventory cycles. That something so workaday as supply-chain management could have so marked an effect might seem a dull conclusion. But dullness is a virtue, because technological improvement is irreversible. This means the greater stability it provides is likely to be permanent.

The Wall Street shuffle

If better logistics is an unalloyed plus for the economy, the benefits of financial innovation may seem

more doubtful—at least just now. Complex derivatives, such as collateralised debt obligations (CDOs), have created a truly nasty mess (see article). But if credit has perhaps been too easy to come by, that was itself a novelty. Credit was strictly rationed until a wave of deregulation and innovation during the 1980s and 1990s led to an expansion. That, in turn, gave a wider range of firms and consumers the means to plug temporary gaps in spending power.

Credit scoring and securitisation have attracted plenty of scrutiny in recent weeks. But the use of techniques to assess the risk of default, together with the repackaging of loans into marketable securities suitable for savers, has broadened access to borrowed funds and broken the rigid link between income and spending. No longer are investment plans tied to the vagaries of a firm's cash flow. And consumers can better match their spending to lifetime incomes. A bigger credit pool means transient declines in earning power need not trigger a downward spiral of falling demand and falling income. These are all valuable advances that smooth out the business cycle.

The third explanation for the moderation is that central banks, in getting to grips with inflation, have fostered more stable economic growth too. Indeed, so widespread is this assumption that the power of central banks is sometimes exaggerated. The rally in the world's stockmarkets over the past month has probably been driven by “faith in the Fed”: the belief that America's central bank will cut interest rates by enough to prevent recession.

In principle, controlling inflation helps steady the economy. High inflation tends to be volatile and research has shown that erratic inflation and large fluctuations in GDP growth tend to go hand in hand. That statistical link might be more than chance. High and variable inflation interferes with the smooth functioning of economies. It obscures the changes in relative prices that tell producers about how customer tastes are always changing. It also leads to variations in real interest rates and volatile patterns in spending.

Though the theory is compelling, empirical studies have struggled to pin down a strong link between better monetary policy and tamer cycles. Ben Bernanke, head of the Federal Reserve, has argued that “the policy explanation for the Great Moderation deserves more credit than it has received in the literature.” At the very least, central banks have stopped adding to economic volatility, even if they have not done so much to actively reduce it.

The shock-absorber that shocked

Although it is perverse to argue the golden age has not been tested, it would be foolish to rule out a shock (or combination of shocks) that might break the economy's resilience. Combine the present discord in credit markets with the seeming vulnerability of housing markets and it is all too easy to imagine the rich-world economies in trouble.

What makes today's turmoil so disturbing is that one of the mechanisms which helped stabilise growth has suddenly become a threat to it. Financial innovation is central to the Great Moderation, but its most recent creations allowed credit to be extended on too easy terms. The fallout is now poisoning the markets for short-term funding that are so essential to the economy's smooth functioning.

Because of rising arrears and defaults on American subprime mortgages, investors have lost faith in the securities backed by them. The impact has broadened to a more general revulsion against assets in which the income depends on repayments of consumer debt. As funding dried up, the resulting squeeze has put upward pressure on the money-market interest rates that determine the cost of borrowing for households and small businesses.

As long as credit markets stay impaired, the economy's normal self-regulation cannot fully be relied upon. A channel that for so long has helped smooth economic growth might now threaten it. A shock-absorber could turn into a shock-amplifier.

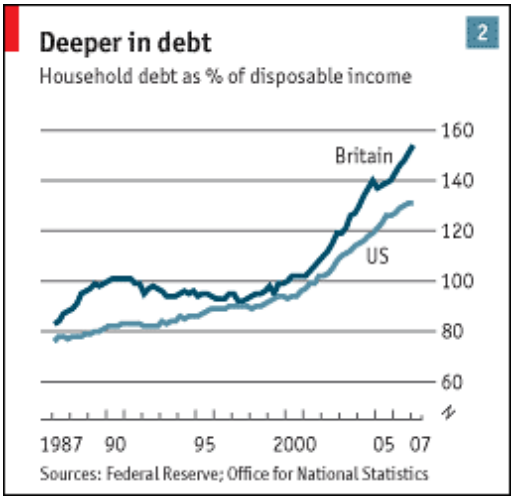
Indeed, the very stability of growth may have encouraged people to take on a debt burden that could prove troublesome. Strong credit growth is both cause and consequence of the golden age.

Belief that the business cycle has been tamed for good helps explain why property prices in many rich countries have risen so high and why there has been such a willingness to take on debt at large multiples of income. A less volatile economy makes income streams more reliable and, goes the argument, justifies higher prices for all assets, including housing. A reduced fear of job losses means homebuyers in America,

Britain and elsewhere have been content to take out huge home loans.

But like all booms, the housing rush is dependent on ever-more risky borrowers to prop it up. Once credit conditions tighten, the marginal homebuyer is frozen out of the market. That is one likely consequence of the trouble at Northern Rock, a mortgage bank that was rescued this week by the British government (see article). Northern Rock was responsible for a huge share of mortgage lending earlier this year. But after a run on the bank its ability to write new business has vanished.

Britain has been growing steadily in the last year, but it has the same fault lines as America—an overvalued housing market, high consumer debt (see chart 2) and a huge trade deficit. Unlike other European countries, it has a big non-prime mortgage market too. Though less than 10% of recent loan growth has been in subprime, this rises to around 25% if you count borrowers who never had to prove how much they earn, according to David Miles, at Morgan Stanley.



Just as the germ carried from America's subprime mortgage market is now infecting money markets elsewhere, so the housing downturn itself could spread globally. As Alan Greenspan, the former Fed chief, reminded everyone this week, there have been housing booms in at least 40 different countries and “the US is by no means above the median”. If global house prices are as correlated on the way down as they were on the way up, the pain will not be confined to America. The cracks that have spread with the credit crisis could be the network through which the housing malaise travels.

As central banks try to mitigate these risks to growth, the danger is that they become complacent about inflation. There is a sorry story of how monetary laxity once undermined hopes for a more stable economy. In 1959 Arthur Burns, then chairman of the National Bureau of Economic Research (NBER), made a famous prediction that “the business cycle is unlikely to be as disturbing or troublesome to our children as it once was to our fathers.” For a decade that optimism seemed justified. But in the 1970s, on Burns's watch as Fed chairman, unemployment rose, inflation took off and a growing sense of economic crisis made a mockery of the idea that governments could control the business cycle. Attempts to fine-tune the economy through cheap money instead led to higher inflation and increased economic instability.

In his new book (see article), Mr Greenspan delivers a timely warning that progress in policymaking is always vulnerable to reversal. Looking to 2030, he fears that the burdens of an ageing population will eventually lead to upward pressure on inflation. And future Fed chairmen cannot rely on the deflationary effects of globalisation to tame prices, as Mr Greenspan could, as over time that impulse will fade.

Mr Greenspan questions the political will to enforce price stability. “Whether the Fed will be allowed to apply the hard-earned monetary policy lessons of the past four decades is a critical unknown. But the dysfunctional state of American politics does not give me great confidence in the short run.”

Once people sense inflation is slipping out of control, changes in expectations can quickly become self-fulfilling. Firms price higher and employees demand wages to match. If inflation expectations slip anchor, central banks will have to ratchet up real interest rates (or bond markets will do the job for them). Policy might again become the source of economic shocks.

Today the stakes are arguably higher. Highly leveraged economies rely on low nominal interest rates to keep debt-service costs manageable. A spike in bond yields would probably cause huge instability as interest costs ate into available spending. If wiser central bankers have indeed played a big role in the Great Moderation, it is sobering to think how easily the dangers of lax monetary policy might be forgotten.

Revising downwards

The prospect of a co-ordinated global housing slump is a very frightening one. For the moment, it remains a plausible risk. If house prices hold up, the credit-market disruption is still likely to harm growth in 2008. Even if money markets settle down—and there are the first signs of this happening (see article)—the loans that banks have been unable to sell as securities will instead sit on balance sheets, crimping their ability to lend. A more careful approach to credit means businesses and households will find it harder to borrow.

That will hurt the world economy.

Banking on the Fed

Private-sector forecasts for developed-world growth are understandably being revised down. Revealingly, the biggest changes have been to expectations about interest rates. The likelihood of rate increases in Europe has been largely written off. And many projections for the Fed funds rate were decisively reduced ahead of the decision this week to cut (see article). In essence, the markets are betting the Fed can save the day. Stockmarkets, at least, do not appear to be priced for a recession—or anything like it.

On this they may be simply following the form book. If central bank actions are credited with mitigating previous downturns, then why not this one? The global economy has proved to be far more resilient than had often seemed likely. And it showed very few signs of trouble before the credit-market dislocations, mostly because growth outside the rich world has been strong.

In July the IMF revised down its projections for economic growth in America for this year, but still upgraded its global economic forecasts because of the strength of the emerging markets. These economies—a source of a big shock only a decade ago—could now prove to be a stabilising force for the world economy. Thanks to their handsomely cushioned foreign-exchange reserves, the fast-growing economies of Asia and the Middle East are now less dependent on capital markets to fuel their growth.

America remains the biggest risk. Even here, where the outlook is gloomiest, recession is not a forgone conclusion. Perhaps the best that can be hoped for—and maybe what policymakers are trying to engineer—is a continuation of the muddle-through growth of the past year or so. That would help contain pressures on inflation without causing excessive dislocation in the economy. But the risks to even this outcome are on the downside.

In the past year, America has become less central to global growth. But it is a big importer and a hard landing would affect other countries. Its fortunes over the next year will still have huge significance for other reasons too. America has been at the leading edge of the Great Moderation and has arguably pushed the boundaries of risk-taking furthest. If America falls hard now, it will be a harbinger for the rest of the rich world.

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The candidates: Bill Richardson and the Latino vote

The man from New Mexico

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AP

Republicans are repelling Hispanic voters. That is good news for Democrats

BILL RICHARDSON is the strongest second-tier contender for the Democratic nomination, and the only one with any hope of challenging the big three—Hillary Clinton, Barack Obama and John Edwards. He has two main selling points. One is his resumé—which includes an incident in which he offended Saddam Hussein by showing him the sole of his shoe. The other is that, despite his name, he is Hispanic. (His mother is Mexican and, though he was born in California, he lived in Mexico until he was a teenager.)

Mr Richardson's resumé certainly sounds presidential. After 14 years in Congress, he was America's ambassador to the United Nations. He has run a large federal bureaucracy (as Bill Clinton's energy secretary), and a state (he is currently the governor of New Mexico). The contrast with the big three is striking. Neither Mr Obama nor Mr Edwards has ever run anything much, and Mrs Clinton's main qualification—eight years as the unofficial chief adviser to a president—is marred for some voters by the fact that she was married to him. One of Mr Richardson's more amusing campaign ads shows him at a job interview where the interviewer shrugs: “For what we're looking for, you might be a little over-qualified.”

Mr Richardson's foreign-policy experience is a plus, especially when compared with beginners such as Mr Edwards and Mr Obama. He has won a reputation for troubleshooting in horrible places, having secured the release of American prisoners in North Korea and Sudan as well as Baghdad. And he proposes a swifter and more complete withdrawal from Iraq than any of his big rivals, which should please Democratic primary voters. On the downside, some of his more ambitious foreign ventures have flopped. A ceasefire he helped broker in Darfur this year, for instance, was instantly broken.

Mr Richardson's domestic experience lends him credibility in crucial areas. A former energy secretary, voters may assume, will know how to tackle climate change. And he is reckoned to be a pretty good governor. He has cut taxes and balanced budgets, buoyed by an oil windfall. He raised teachers' salaries and extended benefits to gay partners of state employees. No one would mistake him for a stereotypical Democrat, though: he favours both the death penalty and gun rights.

He has weaknesses. He is a back-slapping, deal-making kind of politician, which is fine, but he often sounds fuzzy when talking about policy minutiae. And while hardly a slave to Democratic Party fashion, he is not immune to it either. In the 1990s, he supported the North American Free-Trade Agreement; now he says he is “disillusioned” with free trade.

Mr Richardson's Latino heritage will probably help him. Hispanics make up about 15% of the population. Many are not yet citizens and so cannot vote, but the Hispanic electorate will have nearly doubled between 2000 and 2008, from 7.5m to 14m, by one estimate. Hispanics are both the largest and the fastest-growing minority, and their votes are up for grabs. Whereas African-Americans vote monolithically for the same party (the Democrats), Latinos switch back and forth a bit.

George Bush wooed them assiduously and won 40% of the Latino vote in 2004—twice the share his fellow Republican Bob Dole had managed eight years previously. But then nativist Republicans derailed Mr Bush's plan for a more welcoming immigration system. Some of them, such as Congressman Tom Tancredo of Colorado, used alarmist rhetoric that sounded hostile to Hispanics in general. Hispanics duly dumped the Republicans—the Democrats' 19 percentage point lead in 2004 swelled to 39 points in 2006.

Democratic strategists confidently predict that they will maintain their lead among Latinos in 2008. Immigration reform is still stalled, and the top Republican presidential candidates, with the conspicuous exception of John McCain, are pandering to nativist voters. The line-up at Republican presidential debates was all-white until a few days ago, and includes both Mr Tancredo and Duncan Hunter, who boasts he will build not one but two fences along the Mexican border. Neither has a chance of winning, but the contrast with the Democrats is nonetheless stark. Two of their candidates speak fluent Spanish (the other is Christopher Dodd). All attended a debate on Univision, a Spanish-language channel, on September 9th; the Republicans have yet to follow suit.

It is pointless to make long-term predictions about how a group as diverse as Latinos will vote—it depends how each party treats them. But one can wager that Republican raging about illegal immigration will boost the Democrats next year. If they take Florida, a big swing state where 11% of those who voted in 2006 were Latino, it will be hard for a Republican to win the White House. That is also true if they capture Arizona, New Mexico, Nevada and Colorado, which are all heavily Hispanic.

A Latino preference for Democrats, however, does not translate easily into a ticket with Mr Richardson on top. At a recent campaign stop in Las Vegas, he stroked the crowds competently and bilingually, but without displaying much of his rivals' star power. And thanks to his name, many Latinos do not even realise he is one of them. Hillary Clinton, who is better-known and better-organised, is far more popular among Latino Democrats—a poll in March showed her beating him by 60% to 9%. But Mr Richardson is bullish about catching up. He did well in the Univision debate with quips such as: “If you build a 12-foot wall, people will get 13-foot ladders.” He is vying for third place in New Hampshire.

But still, his most realistic shot may be at the vice-presidency. The Democratic nominee is likely to be a white female senator from the north-east. A male Latino governor from the south-west would balance the ticket nicely. One snag, though, is that Mrs Clinton is said not to be a huge fan. It is not clear why, but a joke Mr Richardson told in 2005 cannot have helped.

In a speech at the Gridiron dinner, a Washington event where hacks and politicians traditionally mock themselves and each other, Mr Richardson spoke about Democratic presidential candidates. “We've got a lot of good ones,” he said. “There's Governor [Tom] Vilsack of Iowa—he'd bring back the Midwest. There's [Senator] Joe Biden—he'd bring back the national-security voter. And there's Hillary Clinton—she'd bring back the White House furniture.”

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The Democrats and the unions

Kingmakers no more

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But still worth courting

EVEN at their peak, American unions were never as powerful as their West European cousins. And these days American organised labour is long past its prime. Union membership has dropped to just 12% of the workforce, down from 20% in 1983. Every election year pundits ritualistically ask whether unions remain politically relevant.

The unions did not help themselves in the last Democratic primary. In 2004 organised labour split between former House minority leader Dick Gephardt, whose campaign fizzled out early, and former Vermont governor Howard Dean, whose explosive antics doomed his bid. Union backing did not stop the Democrats' eventual pick, John Kerry, from losing a slew of union-heavy states such as Iowa, Nevada and Ohio in the general election.

Despite this record, this season's Democratic presidential candidates have been dutifully courting the unions. They talked up universal health care and trade scepticism at a debate sponsored by the AFL-CIO, a large American labour organisation, last month. All the main contenders did the same at a conference on September 17th of the Service Employees International Union (SEIU).

John Edwards in particular is betting on union support energising his perpetually third-place campaign. He emphasises his recent experience joining picket lines, and he is running to the left of the other main contenders. The International Brotherhood of Carpenters and Joiners, the United Steelworkers and the Transport Workers of America have endorsed him. Barack Obama, once a civil-rights lawyer in Chicago, also does well in front of the union crowd. But Mr Edwards has enjoyed a long head-start cultivating labour's backing.

Meanwhile, Hillary Clinton has been hurt by her husband's record, particularly on free trade. Mrs Clinton now advertises her vote in the Senate against the Central America Free-Trade Agreement, but scepticism remains.

Still, organised labour has little incentive to continue picking losers, and Mrs Clinton remains the presumptive nominee. The United Transportation Union and the International Association of Machinists and Aerospace Workers have backed her. If the unions have much to gain from Mrs Clinton, Mrs Clinton also has much to gain from the unions. The support of female voters sustains her lead; her campaign could use a few burly men in blue collars.

Many unions may also choose not to make an early endorsement. But come the general election union members will still make fine get-out-the-vote foot soldiers for whoever wins the Democratic nomination, even if union bosses can no longer play kingmaker.

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Health care

If at first you don't succeed

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Hillary Clinton unveils a promising health plan

AFTER months of preparation, Hillary Clinton this week finally put forward her new plan to provide health coverage for all Americans. Crucially, she did it without calling for the large government bureaucracy envisaged by her earlier attempt at reform in 1993, dubbed “Hillarycare” by its detractors.

Barack Obama and John Edwards were quick to dismiss her plan this week, but that may be because her well-crafted effort improves on theirs. The three Democratic candidates' plans are similar in that they all aim to help the 47m or so uninsured to get coverage. However, they differ in important details (see chart).

Then and now

Health-care plans compared

	Clinton 07	Obama	Edwards	Clinton 93
Universal coverage	✓	Not quite	✓	✓
Individual required to buy insurance cover	✓	Only children	✓	✓
Insurers forced to offer coverage to all	✓	✓	✓	✓
Firms required to offer plans	✓*	✓†	✓‡	✓
Reform tax break for employer-based coverage	A bit	✗	✗	✓

*But small firms subsidised †But small firms excluded ‡Only tiny firms excluded

The most important component of Mrs Clinton's plan is its universal mandate. All individuals will be required to purchase health insurance if they are not already covered, just as under a new programme in Massachusetts (and under Mr Edwards's plan). This matters because without such a mandate, many young and healthy people opt out, raising the cost of insuring the remaining, sicker people. Mr Obama slips around on this point, invoking a mandate only for children.

That is because he knows such mandates can be unpopular with many middle class voters, for whom insurance can prove too expensive. To help ease this crunch, the Massachusetts reform plan offers targeted subsidies as well as a rejigging of the insurance market with the aim of ensuring inexpensive, “bare bones” coverage packages are on offer.

Mrs Clinton tackles this problem of affordability in several ways. Her plan also offers subsidies to help the poor buy insurance. Individuals can either buy insurance from private firms directly, through a scheme that currently serves federal employees or from a new scheme modelled on and administered by Medicare, a government programme that treats the poor. (The non-poor would have to pay to join the new programme, which would compete with private health providers.) Most strikingly, she envisages imposing a cap on the maximum premium that any family would have to pay for health insurance: beyond a certain (as yet unspecified) share of household income, the family would get subsidies.

The other half of Mrs Clinton's mandate affects employers. Like her Democratic rivals, she plans to oblige all firms to offer health insurance to workers. Many big firms already do so because the federal government provides a tax subsidy for employer-provided health insurance (but, unfairly, not for insurance purchased by self-employed individuals). But even with this break, small firms often cannot afford to offer coverage, and bigger ones are being forced to cut back.

Mr Obama excludes small firms from his mandate. Mr Edwards insists on a “pay or play” provision: if firms do not offer coverage they must pay what is in effect a payroll tax. Mrs Clinton uses both carrots and sticks. She uses the payroll tax approach with big firms, but gives a subsidy to small businesses to

encourage them to offer health insurance. The sum of all these parts, argues Jason Furman of the Hamilton Project, a policy outfit in Washington, DC, is “a substantively good and politically clever” health plan.

But how much will all this end up costing? About $110 billion per year, Mrs Clinton's team reckons. One way she intends to pay for that is to roll back George Bush's recent tax cuts for the richest people.

She has also unveiled a series of proposals over the past six months that encourage savings in the health sector to offset much of that new cost: improved efficiency, greater use of information technology, electronic medical records, improved quality of care and so on. Independent experts agree that big savings in those areas are possible, but caution that reform will not be easy to implement.

But what if those ambitious savings do not come quickly, or if the subsidies end up costing much more? Regina Herzlinger of Harvard Business School applauds Mrs Clinton's push for universal coverage, but cautions that the cost of her approach may be closer to $150 billion-200 billion per year. If so, would the plan then require a vast expansion of Medicare or huge new taxes—Hillarycare by the back door, as some critics say?

Not necessarily, argues Mr Furman. He observes that alone among her rivals, Mrs Clinton has dared to propose reforming the employer tax break for providing health insurance. Jonathan Gruber of MIT calculates that this tax distortion costs the taxpayer $225 billion a year—money he thinks could be redeployed to scale up the Massachusetts experiment nationally.

For now, Mrs Clinton proposes scaling back the tax break only for the richest Americans, those whose households earn more than $250,000 a year. That would save only a few billion dollars a year, but it would establish that this indefensible but hugely popular tax distortion is no longer untouchable. In time, the proposal could prove to be the thin end of a wedge that overturns that benefit altogether, freeing up a large kitty that could finance the move to universal care.

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Lobbying reform

Mostly cosmetic

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More transparency, no less money

JEFF FLAKE hates “earmarks”, the provisions lawmakers use to designate money for pet projects back home. They are typically snuck into spending bills anonymously and they cost taxpayers billions of dollars each year. Every week Mr Flake, a Republican congressman from Arizona, announces his “earmark of the week” with a press release and a lame joke. A recent winner was $300,000 to renovate the Buffalo Theatre in Pawnee, Oklahoma. “I didn't even know buffaloes could act,” Mr Flake says. But few lawmakers are so scrupulous. Some openly brag about their time at the trough and consider it a type of constituent service.

So Mr Flake is not optimistic about the Honest Leadership and Open Government Act of 2007, a wide-ranging ethics package that Democrats have been working to pass since retaking Congress in last year's election. George Bush finally signed the bill on September 14th, complaining that it did not do enough. It requires that the names of sponsors of earmarks be disclosed openly and at an early stage, for example, but that will not do much to rein in people who are actually proud of them.

Earmarks are only one of the targets of the act. It also calls for increased transparency in “bundling”, the fund-raising strategy in which one supporter co-ordinates contributions from many individuals. Under the new rules, campaigns must disclose the names of lobbyists who bundle more than $15,000 in a six-month period. Some people think that this might simply spur lobbyists to compete harder to raise the most money.

The most effective incentive for campaigns to police themselves is, as usual, the desire to avoid embarrassing situations. On September 10th, for example, Hillary Clinton announced that her campaign would return $850,000 in contributions bundled from 260 donors by Norman Hsu, a mysterious businessman. Mr Hsu is not a lobbyist. It is unclear whether he thought he would gain influence in return for his fund-raising or whether he simply wanted his photo taken with grateful politicians. Either way, he has become a headache for the Clinton campaign since it is alleged that some of the money he bundled may have come from himself, which would violate limits on donations.

The new act does contain some new restrictions against lobbyists that are more specific and will be more effective. Members of Congress are already barred from taking gifts from lobbyists in most cases, apart from the occasional baseball cap or cup of coffee. But some lawmakers have still been insufficiently curious about free “working” trips to Scottish golf courses or the like. Under the new law, lobbyists themselves will face penalties, including jail time, for even offering such gifts. If a lobbyist tries to throw a party for a member of Congress during a national convention, the member may not attend. And senators who leave office will now have to wait two years before taking a cushy job at a lobbying firm, not one. (House members may become lobbyists after a year.)

The Democratic presidential candidates have taken voters' worries about money politics to heart. John Edwards routinely takes aim at Washington lobbyists. If you bring them to the table, he warns, “they'll eat all the food”. Barack Obama has called the need to raise money the original sin of politics. He and Mr Edwards say that they will not take campaign contributions from lobbyists. Mrs Clinton does, but insists she is tough enough to take their money and ignore their requests.

Her critics say this stance shows she is tied to politics as usual. Or maybe she is just being practical. The eventual Republican nominee will surely take money from lobbyists. An opponent without it would be at a financial disadvantage. Ethics reform is an admirable goal. But the current system instead promotes a kind of mutually assured degradation.

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Segregation and Little Rock

Fifty years on

Sep 20th 2007 | LITTLE ROCK
From The Economist print edition

Race issues still run deep

LONG before Bill Clinton was elected president, Little Rock was known for a much bleaker past. In September 1957, its Central High School served as the first important test of the Supreme Court's *Brown v Board of Education* decision. That case declared that state laws establishing separate schools for black and white students denied black children equal educational opportunities.

The test didn't go well in Little Rock. Nine black students faced a hostile white crowd when they tried to enter the all-white high school. Violence ensued, and Arkansas's governor, Orval Faubus, ordered the Arkansas National Guard to prevent the students from entering. In turn, President Eisenhower sent federal troops from Kentucky to escort the students to school. To protest, Mr Faubus shut down Little Rock's schools in 1958 and students had to go elsewhere in the state.

On September 25th, Mr Clinton, along with other local and national dignitaries, will gather on the steps of Central High School to commemorate the 50th anniversary of Central High School's integration, the nine students and their legacy. Little Rock has planned a gala, lectures and much else around the anniversary.

While this is all a polite and glitzy gesture, many see it as a way of covering up problems that plague the city. The area around Central High School is now overrun with abandoned houses used by drug dealers. There is little in the way of city infrastructure, although some developers are taking the risk and investing in the area. Murders are frequent.

Race issues still bubble in Little Rock. Earlier this year, the black-majority school board fired Roy Brooks, the district's black superintendent, because it said he favoured wealthy whites who wanted more schools in their neighbourhoods.

The district has been plagued with racial problems for decades. In 1982, a mostly black Little Rock school district successfully sued the North Little Rock and Pulaski County Special School District and the state, citing segregation. More recently, an election this month to the Little Rock school board descended into an unseemly row about race because one candidate was white and the other black. Some people wonder at all the hoopla. Central High School wasn't even the first school in Arkansas to integrate. That was in Charleston, a small town in the west of the state, two months after the *Brown* decision in 1954. With little fanfare, 11 black students went to school with 480 whites. Unlike the Little Rock Nine, few remember those students' names, nor do they have a statue on the grounds of the state capitol.

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Car emissions

Vermont takes on Detroit

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A small victory in a long campaign

VERMONT may be the state with the lowest number of cars, but the American automobile industry, has just lost big in court there. On 12th September, a federal judge, William Sessions, dismissed their attempt to bar Vermont from imposing tough greenhouse-gas emissions limits on cars and light trucks. The verdict thus upholds Vermont's right to force a 30% reduction in carbon dioxide emissions by 2016.

The carmakers had filed suits against California, Rhode Island and Vermont, both of which had adopted tough regulations originally drawn up in the Golden State. The Vermont case was the first to go to trial.

Under the federal Clean Air Act, individual states may not enforce stricter standards than those set by the federal government. However California, in view of its size, has a special exemption: it can apply for a waiver from the Environmental Protection Agency (EPA) if it wants to enforce stricter clean-air standards. Other states can then choose to follow either California's standards or the federal ones.

Two years ago California wrote its own tougher regulations on carbon dioxide emissions, and applied to the EPA for a waiver. Vermont and a dozen other states want to follow California's lead. Last April the Supreme Court told the EPA that it does have the power to control global-warming gases: the agency had questioned whether they were part of its remit and thus something that California could seek a waiver about.

In a 16-day trial in Vermont last April the industry lawyers pulled out all the stops, asserting that such regulations would be unconstitutional, technologically impossible, financially disastrous, do little to reduce climate change, and limit consumer choice.

In his 240-page ruling, Mr Sessions rejected every one of these arguments. He wrote that “it is improbable that an industry which prides itself on its modernity, flexibility and innovativeness will be unable to meet the requirements of regulation, especially with the range of technological possibilities and alternatives currently before it.”

On whether a tiny state could actually affect global climate change, Mr Sessions again sided with Vermont. Though global warming will not be solved by any one industry or jurisdiction, he wrote, this does not detract from the urgency of the problem or the validity of partial responses to it. California's governor, Arnold Schwarzenegger, who has threatened to sue the EPA for delaying a decision on the waiver, called the ruling “another important victory in the fight against global warming.”

Further legal battles loom. The EPA has yet to respond to California's waiver request, but a hearing on it is now set for October 22nd. And the automakers say they may appeal against the Vermont ruling anyway.

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Hawaii

The wave of the future

Sep 20th 2007 | HAIKU
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Planning for change in America's most expensive state

TOURISTS IN Hawaii last month witnessed an unusual display of marine life: not sea turtles or a rare monk seal, but a line of surfers and swimmers preventing a ferry from docking at Kauai. The Superferry is the first big passenger boat to link Oahu, Hawaii's most crowded island, to two less developed ones, Kauai and Maui. Some say such a link is sorely needed. But critics object that the ferry, which can hold more than 800 people, may interfere with whales and other wildlife, and worry about the added traffic, fishermen and cheap labour it will bring.

The scene in Kauai's harbour on August 26th has been followed by more melodrama. The state Supreme Court ordered a review of the ferry's impact, and another court barred trips to Maui until further notice. Then on September 12th Hawaii's governor declared that the ferry would indeed travel to Kauai at the end of the month, enraging many locals. Sadly, the conflict points to a broader problem in Hawaii: an erratic, at times dysfunctional, way of dealing with change.

On September 22nd a group of civic and political leaders will try to defy this trend, and present ideas for a long-term plan at the “Hawaii 2050 Sustainability Summit”. To date, the vision for Hawaii's future has been hazy. Drive through parts of Maui, for example, and it could be 1958, the year before Hawaii joined the United States. Tall stalks of sugarcane bend in the trade winds. Roosters wander from house to house. Shrouded in clouds is Haleakala, a volcano that reaches 10,000 feet (3,100 metres) above the ocean. On many mornings a rainbow spans from a rugged hill to a distant point in the Pacific.

But other parts of the island look more like California, with throngs of pink-shouldered tourists, strip malls, bulky hotels and clusters of time-shares. It is hard to ignore Hawaii's constant evolution. The question is how to guide it.

The new plan will not be the state's first attempt to think ahead. In 1961 Hawaii created America's first statewide system for regulating land use. Since then there have been myriad schemes to protect the environment and accommodate growth; the most notable is a master plan for the state adopted in 1978. But passing a law is one thing and implementing it is another.

Arguably, no state has such finite resources as does Hawaii. About 2,500 miles (4,000 km) from the mainland, Hawaii has less than 6,500 square miles (16,800 square km) of land. Of this, 48% is classified for conservation and 47% for agriculture. Where to put residents and tourists is a perennial question. The American Planning Association's Hawaii chapter gripes that the state's land-use commission spends too much time on individual projects rather than setting broad plans. The rules for development are onerous and opaque. Many projects must be approved by both state and county governments.

The future of tourism is another point of contention. In 1959, when Hawaii became a state, it received

just 243,000 overnight visitors. Now tourism creates more than one-quarter of Hawaii's tax revenues, and the number of visitors continues to grow (to 7.56m in 2006, up by 17% since 2003). Many in the state consider this good news, but there are perpetual cries that tourism is eroding local culture, infrastructure and natural resources. Tourism also produces lower-paying jobs: inflation-adjusted income in Hawaii has risen by 44% since 1970, compared with a national average of 68%. Some worry that visitors buying time-shares and condos will drive home prices beyond what locals can afford. (Where to fit cheap housing is yet another pressing question.)

Despite a will to diversify, it will be hard to attract new industry. Hawaii is America's most expensive state to do business in, according to the Milken Institute in Los Angeles. Hawaii has lofty electricity costs (nearly 95% of the state's energy supply is imported), soaring industrial rents (almost three times the national average) and America's second-highest state tax burden. Doing business in Hawaii is 16% more costly than in the next most expensive state in Milken's index, New York. The gap would be even wider if the index took Hawaii's shipping costs into account.

There are many ideas for how to solve Hawaii's problems. Some want the state to become more self-sufficient, and advocate a return to an agricultural economy. Others insist that urbanisation is the only way to protect open lands. Further proposals range from investing in alternative energy to promoting eco-tourism. Russell Kokubon, a state senator, explains that the sustainability task force has spent months holding community meetings and polling residents, in the hope that a shared vision for Hawaii will emerge.

Whether the task force will present viable solutions for the state is uncertain: compromise has scuttled many a bold idea. How the sceptical governor will react is another matter. If nothing else, however, the task force has succeeded in starting an organised debate. Surfers can line up again and again to block the ferry and other harbingers of the future. But change is as inevitable as the tide.

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Lexington

Masters of the Senate

Sep 20th 2007
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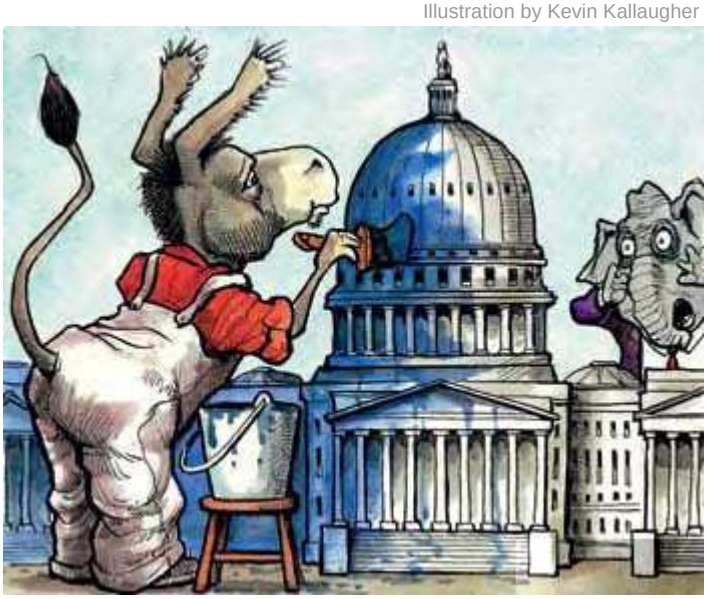
Illustration by Kevin Kallaugher



The Democrats' hopes are not confined to the White House

THE presidential race is so engrossing that it is easy to forget about the other end of Pennsylvania Avenue. The last few days alone have seen Hillary Clinton revisiting health care, the subject that kebabbed her husband's first term; John McCain getting confused over whether he is a Baptist or an Episcopalian; and Alan Keyes, an eccentric social conservative, adding a black face to the Republican line-up.

But the two parties are also engaged in a fierce battle for control of Capitol Hill. And it is a battle that, so far, is even more one-sided than the race for the White House. The Democrats look set to maintain a working majority in the House: polls show the public prefer Democratic candidates for the House by 7-12 percentage points. Seven Republican incumbents have announced their intention to retire, and this week scandal-ridden Jerry Weller of Illinois looked as if he would make it eight. More important, they look set to expand their majority in the Senate from a measly one—which depends on two independents who normally vote with the Democrats—to a commanding six or seven.

The party's blooming prospects in the Senate matter hugely. The Senate ratifies treaties, confirms all the president's important appointments, and tries him if he is impeached. It also allows a cabal of 41 senators to block legislation indefinitely. It is unlikely that the Democrats will reach the magic 60 votes which allow them to break Republican filibusters and force bills to a vote: but if they get close to it, they will much improve the chances for a Democratic White House to muscle through a list of planned reforms, on health care, climate change, immigration and taxes.

The likelihood of this is growing by the day. The Republicans have always faced a tough fight in 2008. They are defending 21 seats compared with the Democrats' 12. They are also defending seats that they won in 2002 when George Bush was wildly popular—his approval ratings are half what they were then—and the Republicans were seen as America's natural champions against the perpetrators of September 11th, 2001. But it is beginning to look as if a tough fight could turn into a massacre.

The Republicans are lagging badly in the race to raise money and recruit candidates. The National Republican Senatorial Committee has only $6.5m in the bank compared with $20.6m for its Democratic equivalent. The Republicans have failed to lure any big names to take on vulnerable Democrats such as Max Baucus of Montana and Tom Harkin of Iowa. And the rising tide of anti-war sentiment threatens to

submerge a slew of Republican senators in Democratic-leaning states, such as Susan Collins (Maine), John Sununu (New Hampshire), Norm Coleman (Minnesota) and Gordon Smith (Oregon).

And that is before you start to factor in the sex and ethics scandals. Alaska's Ted Stevens is under scrutiny by the FBI for improper influence-peddling. New Mexico's Pete Domenici is under investigation by his Senate colleagues for his role in the sacking of a US attorney. Louisiana's David Vitter has admitted to frequenting prostitutes. And Idaho's Larry Craig is still deciding whether to resign over a bizarre incident in an airport lavatory (one wag says that he is seeking advice from his wife and the man in stall number three). This torrent of scandals is not only damaging the Republican Party's family-values brand; it is also forcing it to devote energy to defending territory that it ought to be able to take for granted.

The Democrats' already sunny prospects have brightened still further with a trio of retirements: Virginia's John Warner, Colorado's Wayne Allard and Nebraska's Chuck Hagel are all standing down. Mark Warner is the clear favourite to capture the Virginia seat: a popular ex-governor who leads his nearest Republican rival by 28 points and who has a private fortune of $200m. The Democrats also have a good chance in Colorado, where they already control both state houses, the governor's mansion and one Senate seat, and in Nebraska, if they can get Bob Kerrey, a former governor and senator, to forsake academia for a return to politics.

The Democrats have also succeeded in recruiting prominent candidates to take on Republican incumbents. The biggest recent catch is Jeanne Shaheen, a popular former governor of New Hampshire, who will try to unseat Mr Sununu, the son of George Bush senior's chief of staff and, at 43, the youngest senator. New Hampshire is trending Democratic even more markedly than Colorado—in 2006 the Democrats ousted both Republican congressmen, captured the governorship and took over both state houses—and Ms Shaheen is currently beating Mr Sununu by 16 points in the polls.

Slim hopes

The Republicans have a few straws to clutch at. They point out that someone other than Mr Bush will be leading the party into battle in 2008. They note that the Democrats have a long history of snatching defeat from the jaws of victory. The anti-war left in particular has a genius for alienating the silent majority: witness its decision to impugn General Petraeus's patriotism by dubbing him General Betray-us.

The Republicans are in with a chance of picking up a couple of seats—in South Dakota, where the incumbent is ailing, and in Louisiana, where the Democratic-voting population has not recovered since the great flight after Katrina. But that hardly evens the field. In the wake of their 2006 thumping, the Republicans thought that they could recover given the narrowness of the margins in many Senate races. But the mood among Republicans in the Senate is gloomier now than at any time since Watergate, and many moderates are breaking ranks with the leadership. “It is always darkest right before you get clobbered over the head with a pipe wrench,” one Republican pollster told the *Washington Post*. They will be lucky if is just the one pipe wrench.

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Chile

Jam today, not mañana

Sep 20th 2007 | SANTIAGO
From The Economist print edition

AP

Stronger democracies have brought demands for a share-out of economic growth. Two reports, the first from Chile, the next from Peru (see article)

Get article background

DESPITE a transition to democracy and rapid economic growth, Chileans have grumbled a lot over the past 20 years—but only quietly. Many felt let down by the terms on which General Augusto Pinochet yielded power in 1990, which let him stay on as head of the army for eight years; but their complaints were muted by relief at the return of democracy. Many were also disappointed that the centre-left coalition, called the Concertación, which has governed since 1990, maintained the dictatorship's free-market policies; but that disappointment was tempered by the prosperity and improved services that these policies delivered.

The muted complaints have suddenly become louder. Last year, encouraged by the promise of Michelle Bachelet, Chile's president since March 2006, to lead a more “participatory” sort of democracy, secondary-school children took to the streets to demand better education in the biggest protests since the 1980s. With the price of copper, the main export, at record levels and the economy growing at 6% this year, workers are protesting too.

Until recently, strikes were relatively rare in Chile. Last year, however, miners at Escondida, the world's biggest copper mine, won a hefty increase after a month-long strike. This year has seen stoppages in the forestry industry and a 36-day strike by sub-contracted workers at Codelco, the state-owned copper producer.

“Workers see a country that is growing and companies that are doing well and they're tired of waiting,” explains Arturo Martínez, president of the Central Unitaria de Trabajadores (CUT), the main trade-union confederation. The unions point to Chile's unequal income distribution. A government survey last year found that almost 1m workers, or 15% of the total, were earning less than the legal minimum take-home pay of just over $200 a month.

With unemployment dropping sharply, wage demands are unsurprising. They are also being fanned by the Communist Party. It is aggrieved by the government's failure to act on a campaign promise to reform an electoral system, left in place by the dictatorship, which makes it almost impossible for small parties (such as itself) to win seats in Congress.

Trade-union leaders say the country is on the brink of social conflagration. Certainly, recent strikes have been unusually

violent, as was a national day of protest called by the CUT, the Communist Party and others on August 29th. This gained the support of some Concertación politicians, who have taken to railing against their own government's “neoliberalism”. They object to a strict fiscal policy under which much of the windfall gain from the copper price is being saved for the future. (This will enable the government to spend its way out of any future recession.)

Rather than a big ideological shift, the discontent reflects a change in labour relations. Workers are more aware of their rights and want them respected, says a senior manager at Codelco. One matter of contention is sub-contracting. This has helped to keep exports competitive, but in some industries it has been used as a means of obtaining a low-wage workforce on short-term contracts.

A new law seeks to prevent the misuse of sub-contracting. Last month the government set up a committee to consider broader changes in labour laws. “We're not condemned to look at poverty and inequality and merely wait for growth and the trickle-down of wealth to take care of them,” said Ms Bachelet recently. The government also wants to set up special courts to settle worker grievances and to strengthen unemployment insurance.

Economic, political and social stability since 1990 has been crucial in attracting the investment, both local and foreign, that has secured rapid economic growth. As a result, Chile is a much richer country: income per head is almost $9,000, up from $2,400 in 1990. At this stage in its development, further capital investment and better education should raise productivity and thus wages, in a virtuous circle.

There is plenty of scope for improving productivity. The management of forests and plantations is five times more labour-intensive than it is in Scandinavia, for example. But improving education takes time. And as an alternative to capital investment, Chilean firms can import cheap labour from poorer neighbours, such as Peru and Bolivia, points out Rosanna Costa of Libertad y Desarrollo, a conservative think-tank. That is happening in low-paid jobs in construction and agriculture.

Chileans are throwing off the mental shackles imposed by the dictatorship. The process was accelerated by Pinochet's death last December. But political freedom has bred impatience for a fairer share-out of the fruits of growth. Ms Bachelet has proved less adept than her predecessors at serving up the Concertación's successful recipe of economic liberalism combined with redistributive social policies.

Even so, Chile seems unlikely to veer towards populism. Greater prosperity has brought mortgages and credit-card debts. These are “the new chains of the workers,” complains Mr Martínez. They are also a sign that most Chileans now have a stake in stability.

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Mining in Peru

Revolt in the Andes

Sep 20th 2007 | LIMA
From The Economist print edition

A vote of sorts against big mines

Get article background

MANY of the world's top mining companies have made big investments in Peru and are now ramping up output just when world prices for minerals are at record highs. The government has handed out concessions for exploration covering 12m hectares (45,000 square miles), which it hopes will trigger further investment of $11 billion over the next four years. The industry is booming, as is the economy. But in the Andean highlands that contain the mineral deposits, some Peruvians are turning against the mining companies.

The latest battle is at Rio Blanco, a remote spot close to the border with Ecuador where the Andes meet the Amazon, forming a misty cloud forest. Monterrico Metals, a London-based start-up recently sold to China's Zijin Consortium, plans to develop a huge copper mine there, costing $1.4 billion. Urged on by a loose coalition of environmentalists, Catholic priests and foreign NGOs, local mayors have campaigned against the project. On September 16th they held an unofficial referendum in the three affected districts. Of the 17,971 votes cast (a turnout of almost 60%, said the organisers), all but 984 voted against the mine.

EPA

Not in our backyard, please

Opponents say the mine would pollute rivers that are vital for farmers in fertile valleys lower down and accuse the company of ignoring local opinion. More broadly, they argue that mining has failed to develop the highlands. President Alan García's government denounced the referendum as unrepresentative and claimed its organisers were “communists”.

At Rio Blanco genuine fears and grievances have been mixed with much misinformation and political manipulation, a familiar pattern in Peru. The local mayors say they now want talks on the project. Richard Ralph, Monterrico's chairman, welcomes this as a chance “to dispel some of the myths about a mine that hasn't even been built”. He says that the project will use clean, modern mining technology and very little water, which it will not pollute. The company has promised the few thousand villagers who live close to the mine a community-development fund of $80m over the next three decades.

Monterrico hopes that work on the mine can still start next year, after an environmental-impact study is completed. Other mining companies in Peru will be watching closely. In recent years the industry has tried to clean up its image. But it labours under a legacy of poor environmental practice (some of it when the big mines were state-owned in the 1970s and 1980s). Conflicts between farmers and miners over water use are particularly common.

Modern mines may be much cleaner but they are capital-intensive and generate relatively few jobs. Some economists argue that mines could do more to boost surrounding areas by using local suppliers: one study found that in northern Chile each mining job generates seven others, while the figure in Peru may be lower.

In response to the protests, mining companies are spending more on community development. Half of their income taxes are also returned as local royalties. But local governments often make a bad job of spending this money. And in Apurímac, one of Peru's poorest regions, the national government has rejected all the projects proposed by local communities that would draw on a $40m fund set up by Xstrata, a Swiss firm developing a copper deposit at Las Bambas.

“Mining companies are making huge sums of money right now, but...the average person living near a mine does not see any benefits,” complains Victor Madariaga, who heads the chambers of commerce in southern Peru. In Cajamarca, the site of Yanacocha, a big gold mine, six out of ten residents are still poor (though that figure is lower than a decade ago and includes areas far away from the mine).

Others argue that by focusing on mining's impact on the local economy, the critics miss the point. Mining provides much of Peru's foreign exchange and tax revenues. Some Peruvians argue that more of the windfall from high prices should be taxed: mining's total tax bill was around $2.9 billion last year on net profits of some $7.3 billion, according to the mining society. Taxes have been edging up: the previous government imposed a royalty of up to 3% on new projects; Mr García negotiated a further “voluntary contribution” of 3% of the industry's after-tax profits (raising some $175m this year).

With or without mining, parts of the Andes will remain poor. But with it, Peru's economy can continue to grow fast. For that, the government will have to do more to engineer a modus vivendi. It is looking at reining in labour sub-contracting in the industry. But it has yet to take what is perhaps the most important step: remove environmental regulation of the industry from the mining ministry and vest it in a specialist environmental agency. The future of mining in Peru depends on the government acting as an effective referee. The days when mines could ride roughshod over the locals are well and truly over.

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Mexico

Reforms at last

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The president shows himself to be a successful dealmaker

Get article background

NOWADAYS few Latin American presidents can count on an automatic legislative majority. All too often that leads to legislative gridlock—notably so under Vicente Fox, Mexico's president from 2000-06. But his successor, Felipe Calderón, is showing himself to be an able negotiator. On September 14th, on the eve of independence day, Mexico's Congress approved two weighty measures.

The first is a tax reform—something that eluded Mr Fox. This will increase the government's (non-oil) tax take from 10% of GDP to 12% by 2012, bringing in an extra $10.3 billion next year, according to Agustín Carstens, the finance minister. It will allow the government to cut taxes on Pemex, the cash-strapped state oil monopoly, while starting to meet Mr Calderón's promise to boost public investment by 50%. The reform raises petrol taxes and reduces the scope for the traditional avoidance of income tax by large companies.

AFP

Calderón has something to shout about

Its approval gives the president political momentum as he seeks the energy reform that is next on his agenda. But it came at a price: to acquiesce in an opposition-inspired constitutional amendment on electoral reform. This is the legacy of last year's bitter presidential election, in which Mr Calderón narrowly defeated Andrés Manuel López Obrador of the centre-left Party of the Democratic Revolution (PRD).

The new law halves the length of presidential campaigns and gives the independent Federal Electoral Institute (IFE) power to regulate party primaries. It also cuts public funding to political parties and bans all political advertising except that arranged by the institute in official time slots. This is a blow to Mexico's powerful broadcasters. Raymundo Riva Palacio, a columnist for *El Universal*, a Mexico City newspaper, estimates that the reform will cost Televisa, the dominant broadcaster, 8% of its total revenue in election years.

Many have welcomed these measures as cutting the exorbitant cost of Mexican politics. Less happily, the law imposes an external comptroller on the IFE, to be chosen by Congress; it also replaces the institute's president, Luis Carlos Ugalde, and five others among its nine directors, well before their term expires. That is an infringement of the institute's independence—a crucial cornerstone since 1996 of Mexico's transition to democracy after decades of rule by the Institutional Revolutionary Party (PRI).

The PRD was short-sightedly denied (by party manoeuvring) any representatives on the current IFE board when this was chosen in 2003. It blames its defeat on Mr Ugalde, though without proof.

Mr Calderón will doubtless see all this as an acceptable price to pay for staunching the bad blood left by last year's election. Mr López Obrador had called on his party to boycott the government. But in the past few weeks the PRD has negotiated with Mr Calderón's conservative National Action Party. Many of its members voted for four of the seven fiscal-reform bills. In return, the PAN and the PRI voted with the PRD for the electoral reform. Whether this deal was worth it depends in large part on whom the Congress chooses to replace Mr Ugalde. A competent, independent president for the IFE will strengthen Mexico's democracy—and make Mr Calderón look like a statesman.

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Ecuador

Sharks and other politicians

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From The Economist print edition

A stumbling approach to conservation

Get article background

SHARKS do not evoke the same kind of cuddly feelings as dolphins or baby seals. But when last month Ecuador's president, Rafael Correa, relaxed a ban on the trade in sharks' fins (a highly-prized delicacy in east Asia), he unleashed a storm of protest. That was partly because his government ordered the arrest of a member of Sea Shepherd, an American green group, for taking part in a police raid on fin traffickers. But it was also because the episode highlighted an inconsistent approach to environmental policy by a government that has several green activists in its ranks.

On taking office in January, Mr Correa inherited a pressing environmental problem. For its size, Ecuador is the world's most biodiverse country. With just 0.2% of the earth's land surface, it hosts 18% of its bird species. Tourism, much of it ecological, is now the third-biggest foreign-exchange earner. But with a struggling economy and unstable politics, Ecuador has fallen behind rivals such as Peru and Costa Rica in environmental conservation. In June UNESCO placed the Galapagos Islands on its list of endangered World Heritage Sites.

In a demonstration of his green credentials, Mr Correa named Eliécer Cruz, a former director of the Galapagos National Park, as the islands' governor. He also unveiled an ambitious, if implausible, plan to persuade the world to pay Ecuador not to extract a billion barrels of oil from the Amazon jungle. But he then replaced the scheme's author, Alberto Acosta, as energy minister.

Others in the government argue that conservation should not trump development. “It's very easy to be an environmentalist,” said Carlos Vallejo, the agriculture minister, recently. “Many of them come from well-off families.” Their campaigns amounted to criticising the poor, who were merely trying to put food on the table, he said.

Greens saw Mr Correa's decree allowing the sale of the fins of sharks “accidentally” caught in fishing nets as a bid to win the votes of some 200,000 fishermen in an election for a Constituent Assembly later this month. Fins fetch $60-80 per kilo in local markets—far more than any other catch. Four-fifths of the sharks are caught in the waters of the Galapagos, where fishermen and the eco-tourist industry have long collided. Greens also worry that the government's plans for a new constitution will weaken conservation by devolving powers to regulate sensitive industries, such as shrimp farming and flower-growing, to local governments.

Faced with a public outcry, fuelled by gory images of dead sharks with the fins hacked off, ministers opened talks with Fundación Natura, the main green NGO, over changes to the decree. “Just because we're not 100% environmentalists, doesn't mean we aren't [environmentalists]”, says Fernando Bustamante, the security minister.

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Nepal

Flying the revolutionary flag again

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AP

A Maoist walk-out jeopardises the peace process

Get article background

RATHER than lose an election, Nepal's Maoists seem ready to scuttle it. On September 18th they announced that they were leaving the eight-party transitional government headed by Girija Prasad Koirala. They seemed to realise that they would do badly in elections, scheduled for November 22nd, for an assembly to draft a new constitution. Rather than risk humiliation, they shifted the goalposts, making demands beyond the powers of the interim constitution.

That constitution provides for a “mixed election” to the constituent assembly, with half the members to be directly elected, and half through proportional representation. Expecting to fare better under a fully proportional system, the Maoists' leader, known as “Prachanda”, demanded one be adopted. The interim constitution also promises that the future of Nepal's monarchy will be decided at the new assembly's first meeting. The Maoists demanded that the interim parliament immediately turn the country into a republic.

The two large political parties, Mr Koirala's Nepali Congress and the mainstream Communists, known as the UML, had to decide how much ground to give to ensure elections would be held and peace preserved. There was talk of seat adjustments to ensure that a dozen Maoist leaders made it into the assembly. There were even promises that during the election campaign, all eight parties would make public commitments to vote for a republic.

Ever since a popular movement brought an end to the autocratic rule of King Gyanendra in April 2006, the Maoists' position has been ambivalent. On the one hand, they have submitted to a United Nations-supervised “arms management” process—a euphemism for demobilisation. And, officially, they have given up their “people's war”, which in ten years led to some 13,000 deaths, in order to join open, competitive politics. On the other hand, they have not equipped their cadres intellectually for non-violent politics. Instead they have let loose on the populace a corps of thugs, known as the Young Communist League. And last month a Maoist plenum saw militarist hardliners accuse the moderate leadership of “selling out” the revolution. In defensive response, Mr Prachanda and his chief ideologue, Baburam Bhattarai, stiffened their demands.

It has not helped that the eight-party alliance is run autocratically by Mr Koirala, an ailing octogenarian in his sixth decade in politics. Whether out of choice or infirmity, he is increasingly remote, and has alienated his most important democratic ally, the UML's Madhav Kumar Nepal. As the Election Commission prepared

for polls, the public watched nervously to see whether Mr Koirala or Mr Prachanda would blink first. Instead, the latter averted his gaze and stalked off.

The timing of the Maoists' exit is at best irresponsible. Nepal is tackling three daunting challenges simultaneously: preparing for the first elections since 1999; rehabilitating the victims of the conflict; and restructuring the state, with the monarchy probably being shown the door.

Opportunistic violence has flared in many parts of Nepal over the past year from historically disfranchised groups asserting their demands against the background of abject lack of government. Tensions between the people of the hills and those of the plains are worse than ever. Other linguistic, religious and regional divides are also being exploited. The Maoists' departure from government is likely to encourage violent groups, more of which are being established by the day.

Delaying the election also gives King Gyanendra a breather—hardly the Maoists' intention. The Nepal Army, which waged a dirty war against the Maoists and supported the king's seizure of absolute power in February 2005, may also savour the prospect of a descent into anarchy and turmoil. It would justify its re-emergence from the barracks, where it has been sequestered in humiliation since April 2006. A reinvigorated Nepal Army is surely the last thing that the Maoists would want.

There is still hope, however. Despite the fierce speeches surrounding their withdrawal, Maoist leaders did not reject the peace agreement they signed with the other political parties, nor the interim constitution, and have not left the eight-party alliance. At talks with the other parties on September 20th a compromise was discussed, in which parliament would make some token gesture of support for a republic, but leave the final say to the sovereign, elected constituent assembly.

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Japan's next prime minister

Glad to be grey

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In a remarkable turn, the job is Yasuo Fukuda's to lose

Japan's politics

SOON after he announced on September 12th his intention to resign as prime minister, Shinzo Abe withdrew to the barren consolations of a hospital room and drip, physically and perhaps emotionally broken. No formal handover of power to his chief cabinet secretary, Kaoru Yosano, took place, yet since his resignation nearly nothing has been heard of Mr Abe. It is said that Mr Yosano carries the odd bundle of papers to him. In effect, the world's second-largest economy is leaderless.

Mr Abe's Liberal Democratic Party (LDP) has rushed to find a successor. Elections for the party presidency will be held on September 23rd. Two days later the winner will become prime minister, because appointing one is the job of the lower house of the Diet (parliament), and there the ruling coalition has a huge majority. By contrast, in late July the LDP lost control of the upper house to the opposition Democratic Party of Japan (DPJ), a humiliating defeat that was at the root of Mr Abe's undoing.

It had for months been assumed that the front-runner to succeed Mr Abe, whenever he went, was Taro Aso, grandson of Japan's most notable post-war prime minister, Shigeru Yoshida. Mr Aso was foreign minister under Mr Abe until he was appointed the party's secretary-general in late August in a revamped government and party line-up. Mr Aso, a former Olympic shot and a fan of *manga* comics, has an urbane assurance that once had widespread appeal. Yet so deep runs the anger within the LDP at the nature and timing of Mr Abe's resignation—unnecessary weeks after the election defeat, yet a mere two days after the prime minister had opened a new session of the Diet with Japan's version of a state-of-the-union address—that Mr Aso's ambitions now look shattered.

Not only is he tainted by association with Mr Abe. Mr Aso also knew of the prime minister's intentions a couple of days before the country and the rest of the party's grandees. It was a blunder for a usually adroit politician not to warn his colleagues of their approaching crisis. With extraordinary speed, disgusted members called upon Yasuo Fukuda, a 71-year-old stalwart, son of another former prime minister, to step in, something he had not done last time round. He has already won the backing of all the main factions and looks poised to become prime minister. Mr Aso's surviving hopes lie with the LDP's prefectural chapters, which cast votes along with Diet members.

It would be a novelty if the two candidates had big policy differences. But as far as it is possible to tell, their views are remarkably similar. Neither wants the LDP to revert to the system of regional patronage and public works that Mr Abe's predecessor, Junichiro Koizumi, did much to destroy. But both want to help the presumed victims of market reforms and budget tightening, most of them outside the main cities of Tokyo, Osaka and Nagoya.

If anything, what differences did exist have narrowed. Mr Fukuda, like his father, has argued for full reconciliation with the Asian victims of Japanese imperial aggression, and his ties with China are close. Mr Aso, meanwhile, is a scion of a family cement company that used Chinese and Korean slave labour, and he has a revisionist view of Japan's past. As foreign minister, he proposed an “arc of freedom and prosperity” that conspicuously excluded China. Yet now he claims to be the first foreign minister to welcome China's rise. Only over nuclear North Korea do real differences remain. Mr Aso is adamant that pressure must be used until North Korea dismantles its weapons and explains the mysterious disappearances of ordinary Japanese during the 1970s and 1980s. Mr Fukuda, by contrast, stresses the eventual normalisation of ties.

Reuters

Fukuda forces Aso into the

background

Above all, Mr Fukuda appeals to his party on style. Greyness is back, synonymous with competence. Conciliation and compromise are to get a chance, while flamboyance is out. Even that consummate showman, Mr Koizumi, with no love for Mr Fukuda, has given his backing.

And perhaps the LDP, for once, is smart. For the autocratic opposition leader, Ichiro Ozawa, himself a former LDP strongman, was counting on confrontation to bring down the government. His chosen issue is the extension of emergency “anti-terror” measures sanctioning the refuelling of ships in the Indian Ocean as part of the campaign in Afghanistan. Mr Ozawa has said that the upper house will vote down any extension of operations not countenanced by the United Nations.

Already, Mr Fukuda is unsettling the DPJ. He says he wants to discuss a framework allowing Japan to play a more predictable role in the world's troublespots. The government succeeded in pushing the UN Security Council into thanking Japan and other countries helping fight terrorists in Afghanistan. For Mr Ozawa, this was unwelcome. Many in his party regret the knock to Japan's international standing from the leadership crisis, and do not want to make matters worse by ordering Japan's navy back from the Indian Ocean. One such critic, Seiji Maehara, Mr Ozawa's predecessor as leader of the DPJ, says his successor should follow the party consensus, not pre-empt the debate. As for Mr Fukuda, wanting to survive as prime minister until a budget is passed next spring, and perhaps until Japan's hosting of the G8 summit next summer, he may hope that one compromise wrested from the DPJ will lead to another.

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Pakistan

Musharraf's endgame

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From The Economist print edition

Desperate efforts to cling to power

Get article background

AFP

The general has a few friends left

MANOEUVRING through a constitutional quagmire with all the agility of a soldier on the battlefield, General Pervez Musharraf has not given up yet. This week Pakistan's beleaguered president told the newly independent-minded Supreme Court that he will relinquish his job as army chief if he is elected president by the current electoral college, allowing him to stay in office after his term expires on November 15th. On September 20th the Election Commission announced that the election would be held on October 6th. But the court is hearing several petitions challenging both General Musharraf's right to be head of the armed forces and president at the same time, and the validity of such a presidential election.

The electoral college comprises the two houses of the national parliament and four provincial assemblies. General elections, due to be held by January, would produce a new college. It might be hostile to General Musharraf, although earlier this month his government immediately deported one leading opponent, Nawaz Sharif, a former prime minister, when he tried to return from exile.

The opposition parties have denounced the general's offer as an attempt to soften up the court. They say they will resign from parliament if the election commission allows him to file his nomination for the presidency, which he must do by September 27th. Controversially, the commission has scrapped rules that disallowed government officials (eg, army chiefs) from contesting presidential elections until at least two years after their retirement from public service.

General Musharraf holds the two jobs at present thanks to a constitutional amendment passed in 2003 with the help of the Muttahida Majlis-e-Amal (MMA), an alliance of religious parties. The MMA has now turned against General Musharraf for supporting the war against the Taliban and al-Qaeda at America's behest.

General Musharraf's original plan was to neuter the Supreme Court by sacking its obstreperous chief justice, Iftikhar Chaudhry, last March. That backfired. Three months of pro-Chaudhry protests succeeded in persuading other judges to reinstate their chief in June.

Thwarted, General Musharraf began seriously to flirt with the Pakistan People's Party (PPP), led by Benazir Bhutto, a former prime minister. He hoped to win her support for a constitutional amendment enabling his election as president while still in uniform. Miss Bhutto, who is in self-imposed exile sheltering from corruption charges, seemed willing to help if the general elections were to be free and fair. She was hoping to share power with the general in Islamabad and the provinces.

In the end General Musharraf yielded to pressure from the ruling Muslim League (Q) party, which sees the PPP as its nemesis, to abandon the deal with Miss Bhutto. She has said she will return from exile regardless on October 18th. But she has also said that her party would resign from parliament if General Musharraf tried to have himself elected in uniform. On September 19th one of the general's confidants threatened “extreme decisions”—meaning, presumably, martial law—if the opposition does walk out. But they may not have to. The ball's in the Supreme Court.

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Smoking in Asia

Can't kick the habit

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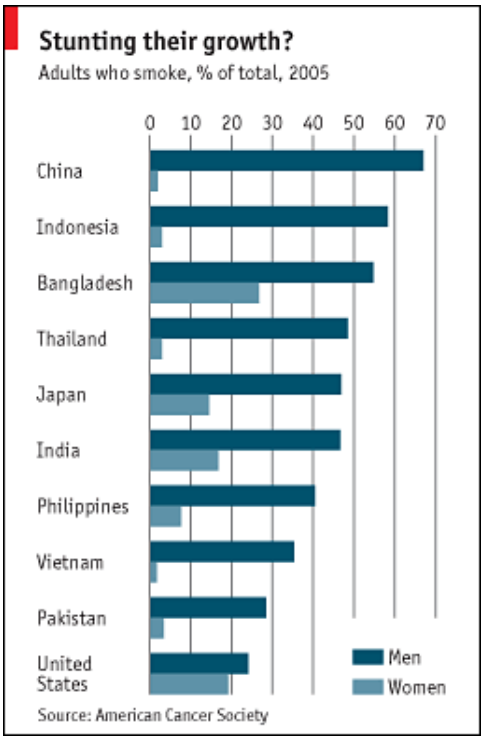
Governments as well as people are addicted to the deadly weed

AROUND 700m Asians, mostly men, cannot get through the day without puffing on a cigarette. The habit is thought to kill around 2.3m Asians every year, almost half smoking's global victims. Cases of cancer and other tobacco-related diseases are rising sharply. But health ministries are taking tougher action against smoking. Thailand, which banned it in most public buildings in 2003, is holding hearings on a plan to extend the ban to all places of entertainment. China's press said this month that cigarette makers would be told to put larger health warnings on their packets, including images of skulls, blackened teeth or diseased lungs.



Cigarette consumption in China soared between 1970 and 1990 but has fallen slightly since. There, as elsewhere in Asia, smoking among men is far more common than in the West. The worry, says Burke Fishburn of the World Health Organisation (WHO), is that Asia will follow the Western trend, with more women taking up smoking as men quit. In Vietnam, for example, cigarettes are being peddled to urban women as a “sophisticated” pursuit.

Western tobacco firms, their home markets shrinking, have turned their attention to developing Asia, drawing fire from anti-smoking groups. But, says Mr Fishburn, a bigger worry is the ambitious plan by China's huge state tobacco monopoly to become a big exporter of cut-price smokes to the rest of the region. Thailand, while extending its smoking bans, also plans a giant new factory for its state tobacco firm.

Almost all Asian countries have signed the WHO's tobacco-control treaty, committing themselves to restricting the marketing of cigarettes, curbing smoking in public and helping smokers to quit. But they will struggle to change entrenched social customs. In China, for example, cigarettes are a social lubricant, pressed on guests, whose attempts to decline them are often ignored, or on those from whom one wants a favour, whose acceptance of the cigarette implies the favour will be granted. Tobacco firms are wriggling around the new restrictions. In India, most outdoor advertising has been taken down since it was banned in 2003 but firms are spending heavily on in-store promotional displays, which are still allowed.

Another big obstacle is that Asia's governments are addicted to the huge revenues they earn from both tobacco taxes and the profits of state tobacco firms. Though Indonesia's government is promising to cap cigarette output by 2010, it is the only one in Asia not to have signed the WHO's treaty, claiming it cannot afford to. Tobacco taxes provide about 10% of government revenue and the industry is said to support some 7m people. Chinese officials also worry about the consequences of curbing the tobacco producers.

However, both nicotine-addled countries may be wrong. In each, tobacco taxes are unusually low by world standards. Studies by the World Bank and others suggest that, though raising tobacco taxes succeeds in cutting smoking, it still increases government revenues. Tougher curbs on cigarette smuggling can have the same effect. Tobacco farmers could switch to growing, say, oilseeds, for which demand is booming. And Asia's tobacco firms, in the short term, says Mr Fishburn, need fear neither higher taxes nor tougher advertising bans: they have so much scope to improve their efficiency that they could boost profits even in a shrinking market.

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Violence in China's schools

Hard lessons

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A spate of attacks points to deep-rooted social troubles

ON SEPTEMBER 13th a man threw six children from a balcony of their school in a small town in central China. A nine-year-old girl was killed and two of the others were badly hurt. Local media tersely reported the news, describing the attacker as mentally ill. America is often thought to have exceptional problems of school atrocities but numerous similar reports in recent years of random killings by intruders in schools suggest there is widespread malaise in China, too.

State-controlled newspapers do not highlight such incidents and offer little explanation of why they occur so often. This latest attack, in the town of Hongqiao in Hunan province, was at least the fifth of its kind reported around the country since the middle of June. The others involved lone adults armed with knives or, in once case, a wrench. These cases have left four children dead and around 30 injured.

As the Communist Party prepares for a five-yearly congress next month, it is not surprising that such incidents are played down. President Hu Jintao hopes the congress will be a ringing endorsement of his accomplishments since he was appointed party chief just after the previous congress. One of his most publicised goals has been a “harmonious society”. This means reducing the social tensions created by rapid economic change.

Mr Hu has not been very successful. In rural areas the number of those living in poverty has continued to fall, but not in cities. The rich-poor gap has widened. Lone intruders in China's schools, experts say, are often people who feel powerless and alienated in a fast-evolving society where many others are faring much better. Li Meijin of the Chinese People's Public Security University says that few of the assailants would be classified as mentally ill. She says they are usually poor, ill-educated members of a “disadvantaged community”, such as migrants from rural areas, who direct their anger at people even weaker than themselves.

The leadership has been paying attention, if the press has not. In 2004 a spate of violent incidents at schools prompted President Hu to call for better security measures. At a press conference in April, an education official was asked about plans to give the public more access to sports facilities at state-run schools. He stressed the need for caution given the problem of people “disgruntled with society” entering classrooms to knife students. But guarding schools effectively is difficult and loads a big burden on those unable to attract the high-fee-paying middle classes.

Ms Li says better security measures have helped curb violence in crowded places such as railway stations and shopping centres. New rules were introduced last year to tighten control over access to explosives, which at the time were readily available and much in demand among those with grudges. But she says schools and hospitals remain easy targets.

Liu Neng of Peking University says the threat is unlikely to abate soon given the continuing pace of change in urban China. With decades-old communities being uprooted to make way for construction, residents are far less able to keep tabs on their neighbours. Those in distress can easily go unnoticed. Despite widespread cynicism about Mr Hu's “harmonious society” project, Mr Liu says it is at least helping to focus more government attention on the socially marginalised. The recent attacks suggest a lot more effort is needed.

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Myanmar

Monks on the march

Sep 20th 2007 | BANGKOK
From The Economist print edition

The junta incurs the powerful clergy's wrath

Reuters

Meritorious service

Get article background

THE generals who rule Myanmar must have been hoping they had successfully crushed the protests over their drastic increase in fuel prices last month. Arrests of suspected protest leaders and attacks on demonstrators by civilian goon-squads seemed to be doing the trick. But then, earlier this month, the army incurred the wrath of the country's respected Buddhist clergy by firing over the heads of a group of protesting monks in the central town of Pakkoku.

Some reports said monks were also beaten and arrested. The clergy demanded an apology. The junta refused. So the monks took to the streets of Yangon and other cities in their thousands, marching and chanting prayers. They urged laymen not to join the protests. They have also threatened, in effect, to excommunicate the junta by refusing to accept alms from them.

Raising the stakes, the army fired tear-gas canisters and warning shots to break up one of the biggest protests this week, in the western town of Sittwe. For two days, plain-clothes security men blockaded the golden Shwedagon Pagoda in Yangon, the country's most sacred Buddhist shrine. On September 20th they gave way and allowed around 1,000 monks, who had marched on the shrine through the pouring monsoon rain, to enter it. *Irrawaddy*, a newspaper run by Burmese exiles from neighbouring Thailand, claimed the junta had declared an emergency and authorised its forces to open fire on protesters if necessary.

All of this has recalled the mass pro-democracy uprising of 1988, which the regime put down harshly with the loss of thousands of lives. That, too, began in economic disgruntlement when the junta abruptly cancelled high-value banknotes. It then spread to a political movement in which students and monks played leading roles. Two years later the clergy imposed a boycott of military families similar to the one now being threatened.

This week's, like other, smaller protests over the years since then, failed to budge the junta. Hopes have risen, time and again, that demonstrations would gather momentum and trigger an unstoppable revolt, only to fade away.

But if there is one group in Burmese society that the generals might hesitate to confront, it is the clergy. Not just because it might whip up the masses to overthrow their tyranny at long last, but because of the influence Buddhists believe they have over the process of rebirth. Giving alms to monks is one of the main ways to make “merit”, so if this is denied the generals, they may lose their chance of advancement in their next life. A punishment amply merited.

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Correction: Japanese politics

Sep 20th 2007
From The Economist print edition

Contrary to our leader last week, “The trouble with one-party rule”, the next elections for half the seats in the upper house of Japan's parliament are not six years hence, but will be held in 2010. Sorry.

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Israel and the Palestinians

The remarkable survival of Ehud Olmert

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From The Economist print edition

Illustration by Claudio Munoz

Does the Israeli prime minister's resilience bring peace closer?

EVEN those who detest Ehud Olmert profess a grudging admiration for him these days. A few months ago the Israeli prime minister looked as if he would soon be out of a job, after a damning report by a commission of inquiry into the previous summer's war in Lebanon. Either a revolt within his own centrist Kadima party or a defection by its main partner, the Labour party, would topple the coalition government. Now Mr Olmert has a fair chance of lasting well into next year and perhaps beyond—even, some say, until the end of his four-year-term in 2010.

That might be optimistic: no Israeli leader has done it since 1981. But it still testifies to Mr Olmert's staying power. He owes it partly to a knack for wrongfooting his rivals—notably Tzipi Livni, his foreign minister, who challenged him to resign after the commission's report in May, expecting mistakenly that he would sack her instead—and partly to the vagaries of domestic and foreign politics. June's victory in Gaza by the Islamists of Hamas, who reject peace with Israel, over the forces of the secular-minded Palestinians of Fatah made Israelis more sceptical of peace than ever, and thus of any more doveish policy that Labour might adopt in an attempt to launch an election bid.

And then there was the reported raid on September 6th by Israeli jets over Syria. While Israel has maintained tight censorship save for some offhand comments by Binyamin Netanyahu, the opposition leader, leaks to the foreign media, mostly from American officials, suggest that they hit some kind of fledgling nuclear facility with material or equipment supplied by North Korea. Many analysts are treating the claim with scepticism, but the continued silence from Israel and Syria about what actually happened has convinced the public that Israel must have hit something important. That has given a fillip to Mr Olmert's abysmally low popularity.

The question is what he can do with it. Since last year, the public appetite for his original election platform—a unilateral withdrawal of Israeli settlements from the West Bank—has evaporated. Now, he is focusing on the American and Israeli attempt to boost the Palestinian president, Fatah's Mahmoud Abbas: the idea is to improve life for Palestinians in the West Bank while keeping Gazans teetering on the edge of a humanitarian disaster, in the hope that they will turn against Hamas.

Making life hard for Gazans is the easy part. Gaza's border crossings have been closed to all but humanitarian supplies and a handful of farm shipments since June, making the strip's already rickety

economy collapse. This week Israel declared Gaza an “enemy entity” to justify new sanctions in response to a rain of home-made Qassam rockets into southern Israel. It will begin by cutting off electricity, then fuel, and closing the crossings to all but food and medicine. Human-rights groups and aid agencies denounced the move as collective punishment of the strip's 1.4m inhabitants, banned by international law. The UN secretary-general, Ban Ki-moon, complained too.

Making Mr Abbas more popular is harder. He is as anxious as anyone to see Hamas squelched, but risks looking to his people like a traitor. Key to the strategy is a peace summit scheduled for November, which various pro-Western Arab leaders are meant to attend in order to put their imprimatur on a joint Israeli-Palestinian declaration about a future peace process.

But the Israeli and Palestinian leaders are still far apart on what their declaration should declare. Mr Abbas wants details and timetables about how to move towards a final deal, arguing that nothing less will convince either ordinary Palestinians or Arab leaders. The Saudis, without whom the conference will have little credibility, are threatening not to show up. Diplomats are already hinting that the summit may be delayed again.

Israel wants something vaguer. Moving too fast, says a government spokesman, carries the risk of loading excessive demands on Mr Abbas's shaky interim government. Israel, he says, is keen not to repeat the Camp David peace talks of 2000, whose collapse ended up weakening the Palestinian peace camp, strengthening the extremists and setting off a renewed onslaught of violence.

Such solicitous concern for Mr Abbas and his fellow moderates is, of course, at least partly a cover for Mr Olmert's own political calculations. He may be stronger than before, but the right-wing parties in his coalition, the religious Shas and the Soviet-immigrant Yisrael Beiteinu, have given warning that they will abandon the government if he makes too many concessions to Mr Abbas. There is an element of bluster in such threats; Yisrael Beiteinu in particular is loth to be left out in the political cold. But it narrows Mr Olmert's room for manoeuvre. It also means that even if the summit is successful, there are doubts about how far he can go down the path towards a Palestinian state.

Still far apart

The chances of bridging the gap between Israeli caution and Arab scepticism do not look high. This week Condoleezza Rice, the American secretary of state, made one of her flying visits to the region to try to push Messrs Olmert and Abbas closer together. She has drawn criticism from previous American peace envoys for not doing enough such diplomacy in the past, and there was no sign as she left that either of them had shifted position. Her inability to push harder may reflect the fact that even in Washington some officials have always doubted the summit's merits.

If the summit is a damp squib or does not happen, it will be a blow to the boost-Abbas strategy. Israel has said it will start to remove West Bank checkpoints here and there, and Tony Blair, the new Middle East peace envoy, will next week explain his plan to build up the capacities of Mr Abbas's government, but a few improvements to the quality of life in the West Bank will impress Palestinians far less than a real move towards statehood. Israel, though, does not look prepared to go out on such a limb. The summit, says the Israeli spokesman, is “important, but not the end of the process.”

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France and Iran

Let's keep squeezing them harder

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France's new president is adopting new diplomatic tactics over Iran

Get article background

IN MAY last year, when the Americans first offered to join direct talks with Iran over the future of its nuclear programme, French diplomats were jubilant. At last, their line went, the Americans were giving a chance to diplomacy, as the French had long advocated; military options seemed in retreat. So what was Bernard Kouchner, the French foreign minister and co-founder of Médecins sans Frontières, a humanitarian charity, doing this week declaring with regard to Iran that "it is necessary to prepare for the worst...the worst is war"?

France's new president, Nicolas Sarkozy, has long argued for both a tougher stance towards Iran than that of his predecessor, Jacques Chirac, and a warmer approach to America. In the last months of his presidency, Mr Chirac mused publicly that it might not be so dangerous after all if Iran acquired a nuclear bomb. Mr Sarkozy, by contrast, on a trip to Washington a year ago while a presidential aspirant, called that prospect "terrifying", and declared that, to prevent it happening, "all options should be left open"—a deliberate echo of Bush administration language. In August, President Sarkozy spelt out bluntly the stark alternatives that he wanted to avoid: "the Iranian bomb or bombing Iran".

AP

Sarkozy warns the ayatollahs

Mr Kouchner appeared to ratchet up the pressure. In a broadcast interview, he said not only that war against Iran was something to be prepared for, but that French officers were putting together "plans", though he stressed that these were evidently "not for tomorrow". This formulation was even bolder than George Bush's in public. Iran's state-controlled news agency replied testily that "the new occupants of the Elysée want to copy the White House".

What to read into this apparently belligerent French posture? French diplomats, some of them privately taken aback at Mr Kouchner's comments, insisted that his remarks had been taken out of context and that there was no change in policy. Military contingency plans, they say, are just a routine exercise in scenario planning. "The point is not that all options are on the table," says one top diplomat, "but that all the risks are on the table." Mr Kouchner himself, on a trip to Moscow, designed in part to drum up Russian support for a third UN sanctions-bearing resolution on Iran, also toned down his words. "Everything must be done to avoid war," he said, arguing that negotiations and sanctions were the priority and that there were "no threats of war, at least not from France".

In reality, under the hyperactive Mr Sarkozy, the French are impatient with the slow progress in winning support among Security Council members for a new UN resolution. Russia and China are stalling, arguing that they want to wait for Iran to answer questions from the International Atomic Energy Agency, the UN's watchdog. This is why, while still working on the UN track, the French are also pushing for sanctions outside the UN, through the European Union. The idea would be for EU countries to get their companies, including banks, to stop activities in Iran, rather as America has done. French diplomats say they have not asked French companies to withdraw, but that they are already advising them not to tender for new contracts.

A European sanctions regime of this sort, which the British also favour, could help on two counts: to persuade America that there is more mileage in diplomacy, while also showing the Iranians that their delaying tactics will not get the world off their backs. The French are not pushing for a military option.

What they want at this point is to persuade the public of the danger presented by Iran, to carve out a bit more manoeuvring room for diplomacy, and to make sure the Iranians know that France under President Sarkozy is serious about keeping up the pressure on them.

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Iraq

Privateers under fire

Sep 20th 2007
From The Economist print edition

Will Iraq's government dare dispense with the West's private armies?

Get article background

THE shooting that killed at least 11 civilians at a crowded Baghdad road junction on September 16th may have been just another entry in the city's annals of bloodshed. That is, if it had not involved Blackwater, one of the most prominent, and by some accounts the most aggressive, of the private military companies in Iraq.

The incident has provoked an extraordinary row between America and the Iraqi government over who really runs the country. It also exposes the role of security contractors in Iraq—a private army of some 20,000 to 30,000 men, second only to the American forces—in protecting officials, escorting convoys and guarding buildings.

Iraq's ministry of interior said it had “suspended” Blackwater's licence to operate, in effect stripping American officials, including the ambassador, Ryan Crocker, of the bodyguards they use to venture outside the protected enclave known as the Green Zone. The Iraqi government may utterly depend on America for protection. For the moment, though, America has not dared undermine the proclaimed sovereignty of its insubordinate allies.

Precisely what happened and how many died in the latest of several incidents involving Blackwater is unclear. The State Department says the guards were defending themselves after a diplomatic convoy was ambushed by a car bomb; the Iraqi authorities, backed by eyewitnesses, say Blackwater's men opened fire without provocation. “We will not allow Iraqis to be killed in cold blood,” said the prime minister, Nuri al-Maliki. “What happened was a crime. It has left a deep grudge and anger, both inside the government and among the Iraqi people.”

Condoleezza Rice, the American secretary of state, expressed regret over the deaths and promised an investigation. But unlike previous incidents that have been hushed up, this one would not go away. The American embassy banned its officials from moving outside the Green Zone without military escorts in order to “assess mission security and procedures, as well as to assess a possible increased threat to personnel travelling with security details.” The Iraqi government appeared to retreat from an early threat to throw Blackwater out of the country, although it insisted that those responsible for the shooting would not have “immunity for their mistakes”.

Iraqis may dislike foreign soldiers, but they dislike even more the foreign armed men they often regard as more trigger-happy and bullying. Even among its peers, who want to shed their mercenary image, Blackwater is seen as the most gung-ho of security companies.

Few had heard of it before March 2004, when four of its guards were killed in an ambush in Falluja and two of the charred bodies were strung over a bridge. The incident sparked the first of two big battles over the city. Since then, it has been called the Bush administration's “praetorian guard in the war on terror” and fancies itself as “the FedEx of America's forces”. So some of its rivals have enjoyed a bit of *Schadenfreude* over its woes. Their worry, though, is that Blackwater's troubles will undermine the whole industry in Iraq.

The privatisation of military functions, from logistics to maintaining weapons, has reached the point that the Pentagon now regards contractors as an integral part of its “total force”. America could not go to war without them. But in Iraq they operate in a legal grey zone. It is unclear, for instance, whether Blackwater has or even needs an Iraqi licence to operate. Security companies are immune from Iraqi law. Though subject to rules on the use of force by governments that hire them, none of the guns for hire in Iraq has been prosecuted; some have been fired or sent home. Will Iraqi leaders dare rescind the

immunity and risk losing the vital services of the security companies? That will be a real test of sovereignty.

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Libya

A Seif pair of hands?

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Muammar Qaddafi's modernising son promotes his own plan for the future

THE ruling family seems to have a vision thing. It was 32 years ago that Colonel Muammar Qaddafi, still fresh from the coup of 1969 that toppled the previous dynasty, proclaimed his Third Universal Theory, aimed at turning Libya into a model of applied socialism and popular democracy. Now his son Seif al-Islam, seen by some as a likely successor to the leader, has unveiled a different kind of vision for his country. The younger Qaddafi proposes to turn some 2,000 square miles of it (nearly 5,000 square km) into a giant ecological park that he hails as “the world's first sustainable development” of a regional-scale environmentally sound model.

The elder Qaddafi's vision, outlined in his famous “Green Book”, has not worked out quite as hoped. Despite its population of only 6m and the great wealth brought by having Africa's largest crude oil reserves, Libya has not markedly progressed. Notionally free public services, plus hefty state subsidies on food and housing, scarcely mask such ills as low educational standards, dirty streets, skimpy wages and a level of youth unemployment that some put at 40%. Instead of producing good government, Libya's unique political system has created rule-by-committee on a scale so bewildering that the only effective institutions are reckoned by many weary Libyans to be the Qaddafi clan and the pervasive, nasty and capricious secret police.

Reuters

The younger, greener Qaddafi

Yet Libya has lately been changing, in many ways for the better. Long scorned by Western nations for its involvement in terrorism during the 1980s, Mr Qaddafi's regime has slowly reingratiated itself. Having crushed a home-grown jihadist insurgency in the 1990s, it has joined America and its allies in the global struggle against al-Qaeda and its allies. Libya's sharing of intelligence, its decision in 2003 to scrap a secret nuclear-weapons programme, and its willingness to free five Bulgarian nurses whom its courts had sentenced to death for allegedly deliberately infecting hundreds of children with HIV/AIDS, have been rewarded by a sharp upgrading of diplomatic ties. America's secretary of state, Condoleezza Rice, is expected soon, and Libya will also soon host UN-sponsored talks aimed at ending the Darfur crisis in neighbouring Sudan.

With high oil prices generating a windfall, and with Libya's energy potential still largely unfulfilled, the easing of political strains has heralded an influx of hopeful investors. The sole world-class hotel in the capital, Tripoli, is booked months in advance. Dozens of firms have swarmed to bid for concessions in the latest auction by Libya's oil ministry, which is offering some 41 gas and oil exploration blocks covering 72,000 square kilometres. The Libyan government is starting to spend, with big projects to revamp airports, roads and ports.

If Mr Qaddafi's son Seif has his way, some more fundamental revamping may be in store. Though he holds no official post except as head of a charity foundation, the younger Qaddafi has emerged as the champion of a kinder, gentler Libya. Last month, speaking before 20,000 youths in Libya's second-largest city, Benghazi, he called for Libya to adopt a constitution and to make both the judiciary and the central bank independent. A media company owned by The Engineer, as he is known because of a brief term as an architecture student, has promoted more openness by launching Libya's first non-state TV station and newspapers.

His idea of an ecological park, though limited to a single region, could represent an even bigger break with Libya's isolationist, xenophobic past. It would involve switching control of much of the desert country's most fertile region, known as the Green Mountain, to an agency that would implement state-of-the-art development plans forged by a bevy of consultants, scholars and engineers from abroad. Judging by the buzz at a party to launch the project amid the spectacular ruins of the ancient Greek city of

Cyrene, these plans would involve everything from solar power generation to micro-finance to the building of posh “carbon-neutral” hotels.

This could all be nice for Libya, and for a scenic region whose current backwardness is due partly to its having been a centre of resistance, both against Italian invaders in the 1920s and to the Qaddafi regime. But as with The Engineer's other initiatives, it is not clear that his good intentions can produce more than cosmetic change. Seif al-Islam has several siblings. Some are closer to their father, and several are less nice than their visionary brother. It would be a shame if his green visions fade as palely as the Third Universal Theory.

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Congo

Who benefits from the minerals?

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A review of mining contracts may well be a sham

Get article background

THERE is nothing new in Congo's staggering wealth benefiting the few and bringing misery to the many. When peace finally prevailed in 2003, after the last big Congolese war, the transitional government signed several dubious contracts with foreign companies that bought concessions at give-away prices to exploit vast tracts of copper-bearing land. Some disenchanted Congolese and sceptical foreign observers complained, but most people's attention was on holding the first multi-party elections in more than 40 years, so little was done. Still, after the government announced a review of all mining contracts in April, hopes rose that the principle of accountability would be taken seriously. Such hope has begun to fade.

More than 60 contracts between private firms (nearly all of them foreign) and Congo's state mining companies were to be reviewed. A clutch of other concessions would also be looked at. A government-appointed commission would check whether companies were abiding by the mining code, paying the right taxes and investing in infrastructure and social services, as they promised. In short, President Joseph Kabila's government had apparently bowed to calls for more transparency in mining contracts and for more revenue to go to the state and Congolese people.

The surge in commodity prices had a lot to do with this. Companies with new deals to exploit copper and cobalt in the mineral-rich Katanga province were making hundreds of millions of dollars on stock exchanges across the world. But few of them had actually dug up any ore. By one estimate, the state's direct income last year from mining was a paltry $32m.

Once the commission makes its recommendations, says Victor Kasongo, Congo's deputy minister of mining, the government will decide whether to leave the deals untouched, renegotiate or cancel them. He says the government has lined up international firms to negotiate with the companies concerned on its behalf, probably in a European country. A couple of deals have already been cancelled: one for uranium, another for copper and cobalt. A row has broken out over the legality of one of the cancellations.

All the same, worries are growing. The review, like the mining sector it is intended to clean up, is shrouded in secrecy. Little information is being made available; what does seep out seems to change every day. The contracts are meant to be open to public scrutiny, but few have proved to be. Excuses range from a claimed need for confidentiality to the cost of photocopying.

The government appears to have rejected a proposal for a truly independent body to oversee the review; parliament has been sidelined; and fears are growing that the commission will remain politicised. Much of Congo's mining sector is already controlled by an elite surrounding Mr Kabila, many of whom are from the mineral-rich province of Katanga.

International mining executives have been rushing to Kinshasa, Congo's capital, to badger friendly officials. Others have put advertisements in Congolese newspapers to show how much they have done for the country. One says that his company was asked for money in exchange for a favourable hearing. “There is little that gives us any confidence in the process,” says Patricia Feeney, who runs Rights and Accountability in Development, a watchdog that monitors corporate responsibility in the poor world.

Recently, China has been the beefiest country to spot new opportunities. This week Congo's government announced that China would lend $5 billion to build new transport infrastructure and help rehabilitate Congo's mines. Congo says it will repay the loan by granting mining concessions and toll rights from roads and railways that the Chinese would build, including a road link to Zambia and a railway from southern Congo to the Atlantic. No questions asked.

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France's economic reforms

A rupture with the past?

Sep 20th 2007 | PARIS
From The Economist print edition

AFP

How Nicolas Sarkozy hopes to avoid a big clash with the trade unions over reform

Get article background

TWELVE years ago, an attempt by a reformist French prime minister to put an end to public-sector pension privileges brought 2m protesters on to the streets and weeks of paralysis to the railways. The plan was duly abandoned and, within 18 months, the enfeebled government of Alain Juppé had been booted out at the ballot box. Now a reformist French president, Nicolas Sarkozy, is trying again. On September 18th he promised to end the so-called “special regimes” as part of a complete overhaul of the social-security and benefit system. Might France be heading for a repeat of 1995?

A total of 1.6m people, working or retired, benefit from the special regimes. These pre-war schemes, set up in part to compensate for unusually dangerous or demanding work, allow electricity, gas, railway and metro workers, among others, to retire early on full pensions. In some cases, such as train drivers who no longer have to shovel coal into their engines, this can mean as young as 50. Elsewhere in the public sector, the retirement age is 60.

Mr Sarkozy has said that he will end these exorbitant privileges, on grounds of “equity”. He wants to bring the special regimes into line with other public-sector workers, as part of a general review of the pension system in early 2008. In order to revamp what he calls a financially unsustainable system that discourages work, he promises also to reform the country's rigid rules on labour contracts, to tighten the welfare rules and to review the public-health insurance system.

The most controversial plan is the end of special regimes. Despite a financing shortfall of at least €5 billion ($6.9 billion), no government since Mr Juppé's has dared touch them. François Fillon, Mr Sarkozy's prime minister, brought in a mini-reform to pensions as social-affairs minister in 2003, but he left the special regimes alone. Bernard Thibault, head of the communist-backed CGT, France's biggest trade union, has promised that, if the government presents its pension-reform plans as a fait accompli there will be “sport, and not only on the rugby field” (France is hosting the rugby World Cup). After Mr Sarkozy's speech the railway unions called a strike for October 17th.

Yet there are grounds for believing that, this time round, threats of mass strikes and demonstrations may be less menacing than they proved in 1995. For a start Mr Sarkozy, unlike Jacques Chirac in 1995, has entered office with a strong electoral mandate for change. During his presidential campaign he explicitly promised to end the special regimes in the name of “fairness”. Nobody can plausibly claim that they did not know what was coming.

Public opinion seems also to favour change. In 1995 well over half of French people said they supported or were sympathetic to strikes against Mr Juppé's plan, according to CSA, a polling agency. Today fully 75% say they support ending the special regimes. It is far from clear that strikes, if they go ahead, will get popular backing (and other union leaders are more cautious than Mr Thibault or the railway unions). Anyway the disruptive power of French unions is not what it was. Workers are no longer paid for days when they are on strike. And in August Mr Sarkozy pushed through a law obliging public-transport workers to negotiate some form of minimum service during a strike.

Most important of all, Mr Sarkozy is taking a novel tactical approach to the unions. Mr Juppé was floored in part by his contemptuous, technocratic attitude towards union leaders. Dominique de Villepin, another former prime minister, was forced to abandon a labour-market reform in 2006 after huge street demonstrations and sit-ins, provoked in part by his refusal even to discuss the plan beforehand.

Mr Sarkozy, in contrast, has gone out of his way to court union leaders, inviting them to the Elysée Palace, and even for lunch at Paris's finest restaurants. He was reportedly dismayed by a clumsy recent comment of Mr Fillon's to the effect that reform of the special regimes “is ready”. Mr Sarkozy prefers to create an impression of flexibility and openness to ideas. “My door is always open to them,” he said—although he has also made clear that he is not ready to listen indefinitely. He wants a deal on pension reform by the end of the year. In separate negotiations between employers and unions over a loosening of the principal labour contract, he has imposed a deadline of December.

In short, France's new president seems genuinely to be trying a fresh approach to the implementation of economic reforms. Does this mean that he will be able to go ahead smoothly with his plans? Nothing is less certain. For one thing Mr Sarkozy's hands-on approach to the presidency leaves him personally exposed. If he runs into trouble, he will not be able to blame his prime minister, as Mr Chirac did Mr Juppé in 1995.

For another Mr Sarkozy, as a lawyer, is by instinct a deal-maker. But deals always involve concessions. The question is how far he is prepared to push, at the risk of provoking conflict. So far he has often sounded tough, but then made concessions. In July, before even the hint of big protests, he dropped the idea of university selection at masters' level in the face of student resistance. More recently, he has diluted his plan to replace only one departing civil servant in two in 2008, as a streamlining measure, to two in three.

It could be that Mr Sarkozy is merely waiting to pick his battle, and that he will show a tougher hand when talks on the special regimes or the labour contract fail. But an alternative is that he might try to “buy” his reforms as part of a grand bargain, in which he takes on new liabilities for the state. This could, for instance, take the form of higher pensions in return for a longer contribution period, or more generous unemployment benefits in return for less onerous redundancy rules.

If he goes down such a road, it would create fresh problems, notably for the public finances. France has postponed its promise to balance its budget, from 2010 to 2012. The budget deficit may be 2.4% of GDP this year. A harsher world economic climate, from which Europe is by no means immune (see article), is not going to help. Even before the latest financial turmoil, the European Commission had downgraded its growth forecast for France, which has fallen well behind Germany. The next few months will test, maybe to destruction, Mr Sarkozy's promise of a rupture with France's past.

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Greece's election

Right returned

Sep 20th 2007 | ATHENS
From The Economist print edition

A narrow win for New Democracy may give it second-term troubles

THE Greek prime minister must be wondering if he was right to call a general election on September 16th, six months early. Admittedly, Costas Karamanlis's centre-right New Democracy (ND) party finished well ahead of the main opposition party, the Pan-Hellenic Socialist Movement (Pasok). But under a new proportional system, its four-point lead over Pasok gave it only a four-seat parliamentary majority, down from 30 in 2004.

The opposition is likely to be a lot more vociferous than it was during Mr Karamanlis's first term. Greece's unreconstructed Communists and their gentler cousins, the Radical Left Coalition, benefited strongly from a protest vote, especially among the young, over the botched handling of recent forest fires. The two parties doubled their total seats, to 36 between them. Not only will parliamentary debate be livelier. Left-wing party bosses can call thousands of demonstrators on to the streets at a moment's notice.

Mr Karamanlis is also committed to two controversial reforms: an overhaul of the creaking pay-as-you-go pension system, and another try at breaking the state's constitutional monopoly over university education. These reforms will test the loyalty of his deputies. But party officials brush off worries that history could repeat itself: in 1993, a handful of dissidents brought down a modernising ND government in a row over privatisation.

Mr Karamanlis could in a pinch seek support from Popular Orthodox Rally (Laos), a far-right party led by George Karatzaferis, a former ND deputy and member of the European Parliament. Laos will enter the Greek parliament for the first time, with ten seats. Its deputies could come in useful if ND needs help. However, Mr Karatzaferis, who denied accusations of anti-Semitism during the campaign but stuck to an anti-immigrant “Greece for the Greeks” platform, could prove an embarrassing ally.

The government has a seasoned ministerial team under George Alogoskoufis, the finance minister. Mr Alogoskoufis will handle talks with the trade unions on raising the retirement age, unifying 150-odd state pension funds and finding professional managers to look after their €33 billion ($42 billion) of assets. But a simmering scandal over sales of complex structured bonds at inflated prices to pension-fund managers appointed by ND threatens to make reform much harder.

Euripides Stylianides, the ambitious new education minister, also has a tough task ahead. A junior foreign minister in the previous government, he was promoted after several cabinet veterans had turned down the job. Although plenty of new Greek shipping billionaires would like to endow non-profit private universities, most professors and students used to the state-controlled system strongly oppose change. Three months of street protests last spring forced the government to withdraw a constitutional amendment that would have permitted private universities.

A leadership struggle in Pasok could at least give Mr Karamanlis a few months' breathing-space. George Papandreou is the mild-mannered party boss (and also the son of Pasok's founder, Andreas Papandreou, just as, to confirm Greece's dynastic tendencies, Mr Karamanlis is the nephew of ND's founder, Constantine Karamanlis). After leading his party to its worst electoral defeat in 30 years, he is fighting to keep his job. His chief challenger is Evangelos Venizelos, a crafty constitutional expert and former culture minister, who has already secured the support of Socialist heavyweights who steered Greece into the euro in 2001. He may become the man to overturn the Papandreou dynasty.

On the campaign trail Mr Karamanlis promised to reduce poverty and to create more jobs. In spite of an economy that has grown by around 4% a year for a decade, one in five Greeks still live in poverty, as defined by European Union standards. The youth unemployment rate of 25% is among the highest in the EU. The public debt is over 80% of GDP. These are the economic failings that need to be dealt with if Mr Karamanlis is to win popular backing for his other reforms.

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Spain and its regions

Autonomy games

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Tensions with the regions ahead of next March's general election in Spain

POLITICIANS can be more loved when they give up power than when they have it. This seems true of Josu Jon Imaz, leader of the Basque Nationalist Party (PNV). His decision to quit has provoked laments all round, including from the prime minister, José Luis Rodríguez Zapatero. Mr Imaz's party won only 1.6% of the vote in the 2004 general election. But, like the Basque country, the PNV punches above its weight. It has dominated Basque politics for 30 years, leading every regional government since 1980, including that of the current premier, Juan José Ibarretxe. And it runs a region that has more autonomy than just about any other in Europe.

It is not, however, its administrative and legislative power over 2.1m Basques that makes the PNV so important to Mr Zapatero. He cares about two other things. The first is the PNV's role as the engine driving what is often the pushiest region in Spain. Where the Basques lead, others (especially Catalonia but also Galicia) try to follow. The second is the party's attitude to, and fraught relationship with, the terrorist group ETA. The PNV would be a vital contributor to any possible peace settlement with ETA; ETA formally ended its ceasefire in June, although (thanks mainly to good police work) it has not since staged any big terrorist outrages.

The PNV is divided both over how hard to press Madrid and over how friendly to be to ETA. Mr Imaz is a moderate “pactist” who wants to be tough on ETA and not too pushy with Madrid. His opponents, the “sovereigntists”, want to be more aggressive with Madrid and gentler on ETA. Mr Imaz's narrow leadership victory four years ago showed how balanced the two factions are. His sovereigntist rival, Joseba Egibar, came within a whisker of victory.

Mr Imaz is against the go-it-alone referendum that has been suggested by the regional government, to ask Basques to decide for themselves what relationship they want with the rest of Spain. The referendum, originally Mr Ibarretxe's idea, is probably illegal under the Spanish constitution. It would certainly trigger a clash with Madrid. But Mr Imaz failed to block a watered-down plan for a referendum in the PNV national council.

By walking away from the leadership, he claimed, there would be no recurrence of the old PNV nightmare: a permanent split. A rival nationalist party, Eusko Alkartasuna, spun off in 1987. And young PNV malcontents helped to create ETA in 1959. The party's future direction now depends on who takes over as leader. Inigo Urkullu, a pactist, is the strongest candidate. But one of the sovereigntists may yet run.

The Basque country is, as ever, being watched intently in Catalonia, which is both bigger and stronger. With a population of 7.1m, Catalonia is home to almost one in six Spaniards. It has plenty of sovereigntists of its own, a few of whom burnt pictures of King Juan Carlos when he visited Barcelona recently. Catalans were also irritated when the Madrid parliament voted this week to bar sub-national sports teams from international competitions.

In Catalonia Mr Zapatero has, at least, done his homework by securing a new autonomy deal that Catalans approved in a referendum last year. He hopes that the new deal has sorted out Catalonia for a generation—and that if a moderate wins the PNV leadership, a similar deal might even work with the Basques. Yet the sovereigntists are now getting noisier in Catalonia, ahead of next March's general election. Spain's regional tensions seem likely to continue for a while yet.

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The Hungarian far right

Changing of the Garda

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Hungary's right-wing opposition is embarrassed by the far right

Get article background

THESE should be halcyon days for Viktor Orban, leader of Fidesz, Hungary's main opposition party. Fidesz leads the ruling Socialists by 20 points in the polls. That is mainly because of the government's austerity measures, but also reflects aftershocks from the riots after a notorious speech by Ferenc Gyurcsany, the prime minister, over a year ago, in which he admitted to lying about the economy before the 2006 election.

Yet Fidesz is in disarray. Its new bugbear is the Magyar Garda (Hungarian Guard), a self-styled civil-defence group. The Garda, whose members wear black uniforms emblazoned with nationalist insignia, is organised by the far right Jobbik party. It was inaugurated last month by Lajos Fur, a former defence minister. Several churchmen attended, as did Maria Wittner, a veteran of the 1956 revolution—and a Fidesz member of parliament. The Garda has only 56 members, but plans for 2,000 more.

Most political parties have been quick to condemn it. “Fascists are gathering,” declared Mr Gyurcsany, accusing Fidesz of making common cause with Jobbik. Jobbik is not represented in parliament, but it co-operates with Fidesz in some localities. Fidesz's initial response was to defend the Garda's right of free association, and accuse Mr Gyurcsany of whipping up hysteria. Yet Jewish and Roma (gypsy) groups have called for action against the Garda. An American congressman, Tom Lantos, who is a Hungarian Holocaust survivor, has promised that no member would be let into the United States, and added that any party that fails to condemn the Garda cannot be a serious partner.

Here lies Mr Orban's dilemma. Fidesz's leaders have condemned anti-Semitism; it was Mr Orban's government in 2001 that instituted a Holocaust memorial day. The party's leaders have written to Hungary's Jewish leaders to reassure them. But Mr Orban also wants to court far-right votes. Although his lieutenants have now distanced Fidesz from the Garda, Mr Orban himself has refused to condemn it, beyond telling diplomats that it is the wrong answer to Hungary's problems. Such equivocation angers allies abroad: Fidesz has links with German Christian Democrats and wants ties with British Conservatives.

Direct support for the far right remains small, at only 2-3%. Yet similar parties are gaining elsewhere: one has just got into Greece's parliament. Activists in Hungary are newly confident. Masked skinheads disrupted a recent Budapest Gay Pride parade. Protesters dog Mr Gyurcsany, screaming abuse at him. Most analysts reckon that courting the far right has cost Fidesz support in the centre, helping it to lose in both 2002 and 2006. Mr Orban may again be the Socialists' best electoral asset.

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Charlemagne

Brussels rules OK

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Illustration by Peter Schrank

How the European Union is becoming the world's chief regulator

A VICTORY for consumers and the free market. That was how the European Commission presented this week's ruling by European judges in favour of its multi-million euro fine on Microsoft for bullying competitors. American observers had qualms. Would a French company have been pursued with such vigour? Explain again why a squabble among American high-technology firms ends up being decided in Brussels and Luxembourg (where Euro-judges sit)? One congressman muttered about sneaky protectionism and “zealous European Commission regulators”. It certainly seemed zealous of the competition commissioner, Neelie Kroes, to say that a “significant drop” in the software giant's market share was “what we'd like to see”.

More broadly, the ruling confirms that Brussels is becoming the world's regulatory capital. The European Union's drive to set standards has many causes—and a protectionist impulse within some governments (eg, France's) may be one. But though the EU is a big market, with almost half a billion consumers, neither size, nor zeal, nor sneaky protectionism explains why it is usurping America's role as a source of global standards. A better answer lies in transatlantic philosophical differences.

The American model turns on cost-benefit analysis, with regulators weighing the effects of new rules on jobs and growth, as well as testing the significance of any risks. Companies enjoy a presumption of innocence for their products: should this prove mistaken, punishment is provided by the market (and a barrage of lawsuits). The European model rests more on the “precautionary principle”, which underpins most environmental and health directives. This calls for pre-emptive action if scientists spot a credible hazard, even before the level of risk can be measured. Such a principle sparks many transatlantic disputes: over genetically modified organisms or climate change, for example.

In Europe corporate innocence is not assumed. Indeed, a vast slab of EU laws evaluating the safety of tens of thousands of chemicals, known as REACH, reverses the burden of proof, asking industry to demonstrate that substances are harmless. Some Eurocrats suggest that the philosophical gap reflects the American constitutional tradition that everything is allowed unless it is forbidden, against the Napoleonic tradition codifying what the state allows and banning everything else.

Yet the more proscriptive European vision may better suit consumer and industry demands for certainty. If you manufacture globally, it is simpler to be bound by the toughest regulatory system in your supply chain. Self-regulation is also a harder sell when it comes to global trade, which involves trusting a long line of unknown participants from far-flung places (talk to parents who buy Chinese-made toys).

A gripping new book* by an American, Mark Schapiro, captures the change. When he began his research, he found firms resisting the notion that the American market would follow EU standards for items like cosmetics, insisting that their American products were already safe. But as the book neared completion, firm after firm gave in and began applying EU standards worldwide, as third countries copied European rules on things like suspected carcinogens in lipstick. Even China is leaning to the European approach, one Procter & Gamble executive tells Mr Schapiro, adding wistfully: “And that's a pretty big country.”

The book records similar American reactions to the spread of EU directives insisting that cars must be recycled, or banning toxins such as lead and mercury from electrical gadgets. Obey EU rules or watch your markets “evaporating”, a computer industry lobbyist tells Mr Schapiro. “We've been hit by a tsunami,” says a big wheel from General Motors. American multinationals that spend money adjusting to European rules may lose their taste for lighter domestic regulations that may serve only to offer a competitive advantage to rivals that do not export. Mr Schapiro is a campaigner for tougher regulation of American business. Yet you do not have to share his taste for banning chemicals to agree with his prediction that American industry will want stricter standards to create a level playing-field at home.

Winning the regulatory race

One American official says flatly that the EU is “winning” the regulatory race, adding: “And there is a sense that that is their precise intent.” He cites a speech by the trade commissioner, Peter Mandelson, claiming that the export of “our rules and standards around the world” was one source of European power. Noting that EU regulations are often written with the help of European incumbents, the official also claims that precaution can cloak “plain old-fashioned protectionism in disguise”.

Europe had no idea the rest of the world was going to copy its standards, retorts a Eurocrat sweetly. “It's a very pleasant side-effect, but we set out to create the legislation we thought that Europe needed.” At all events, America's strategy has changed. Frontal attempts to block new EU regulations are giving way to efforts to persuade Brussels to adopt a more American approach to cost-benefit analysis. That would placate students of rigour, who accuse some European governments of ignoring scientific data and pandering to consumer panic (as shown by European campaigns against “Frankenstein foods”).

But rigour can quickly look like rigidity when it involves resisting competition. There is a genuine competition to set global regulatory standards, as Europe and America have discovered. There are also rising protectionist pressures. Perhaps zealous EU regulators may be what jumpy consumers need if they are to keep faith with free trade and globalisation. Viewed in such a light, even Microsoft's champions might hope that this week's verdict will help global competition in future.

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* “Exposed: The Toxic Chemistry of Everyday Products and What’s at Stake for American Power”, by Mark Schapiro. Chelsea Green Publishing.

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The politics of a bank run

Labour's moment of peril

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Illustration by David Simonds

Gordon Brown may still suffer from a week of financial and political panic

Gordon Brown

SINCE Labour swept into power in 1997, there has been only one brief moment when the government looked really vulnerable. That was when road hauliers blockaded refineries in the autumn of 2000 and the nation seemed about to grind to a halt. But this week's run on Northern Rock has been just as perilous.

As so often in modern politics, it was the pictures that shocked. Britain had not experienced a bank run since Victorian times; it had avoided the bank failures that blighted the American and German economies in the early 1930s. Yet that did not stop long lines from forming outside the branches of Northern Rock once it became known that Britain's fifth-largest mortgage lender, unable to raise the short-term cash it needed from the gummed-up money markets, had requested emergency help from the Bank of England.

The bank run was unexpected and perplexing, since by then Northern Rock could rely on the Bank for support. But the rush to withdraw money was not as irrational as it looked. Many in the queues knew the limits of Britain's niggardly deposit-compensation arrangements.

These offer full cover to a depositor with any one bank for the first £2,000 ($4,000) and then 90% of the next £33,000. The protection is less generous than that in America, where deposits are fully protected up to $100,000 under a federal scheme created in 1933. Furthermore, American depositors get their money back within days whereas compensation in Britain may take up to six months.

As the run on Northern Rock persisted, there was a growing danger that the public might lose confidence in other banks. Stopping the run became imperative. On September 17th Alistair Darling, the chancellor of the exchequer, played the taxpayers' card: he guaranteed all the existing deposits in the bank for as long as the financial system remained in turmoil.

That did the trick. The queues disappeared. The financial panic was over. So, too, was the political panic that had gripped Gordon Brown and his ministers as the bank run persisted. In a further fillip for Mr Brown, a poll taken by Populus on September 17th indicated that the public was more inclined to blame risky mortgage-lending in America than the government in Britain for Northern Rock's woes. Another survey suggested that Labour's lead over the Conservatives had widened.

Mr Brown is not yet off the hook, however, for his reputation rests on being good at running the economy.

His much-touted master stroke when he first became chancellor was giving the Bank of England independence to set interest rates, which helped keep inflation low and economic growth stable. But part of the deal was that the Bank stopped supervising banks.

Now Mr Brown will face awkward questions about how a bank run occurred on his watch, when it was he who designed the regulatory arrangements. And the government now has the difficult task of trying to limit Mr Darling's guarantee, which is supposed to apply only during the current exceptional circumstances.

But it is the longer-term economic impact of the bank run that could prove most damaging to Mr Brown. There have been good solid reasons why the economy has done well in the past decade, notably a labour market that has remained flexible and an increasing openness to immigration. But the long expansion has also had a flakier side. In particular, consumer spending has been sustained by rising borrowing backed by the long house-price boom.

Now lenders will become more reluctant to lend, another blow for a housing market that is looking ever more vulnerable. This week Alan Greenspan, a former chairman of America's central bank, suggested that Britain was more exposed to the credit crunch than America because a higher proportion of its mortgage borrowers had taken out loans at variable rates. What's more, British households are more indebted, in relation to their disposable income, than Americans are.

The damage that a flagging housing market can inflict was made clear in 2005, when stalling house prices prompted a slowdown in consumer spending and a slackening in GDP growth. Both have recovered since then, but house prices have become even more unaffordable and consumers yet more indebted.

While Mr Brown disappeared from sight (an old trick), Conservatives and Liberal Democrats chastised him for permitting these structural weaknesses to emerge. David Cameron, the Tory leader, warned that “an economy built on debt puts economic stability at risk”. Vince Cable, the Lib Dems' Treasury spokesman, said that he himself had warned of a looming debt crisis four years ago.

So far the public seems to have turned a deaf ear to these warnings. Mr Cameron's attempt to link the troubles at Northern Rock with Labour's record on debt may even have backfired by appearing opportunistic. But the message could get traction if the economy deteriorates or would-be home-buyers find it notably harder to borrow money.

Lower official interest rates are almost certainly on the way. Encouraging inflation figures—consumer-price inflation dropped a bit further below the government's 2.0% target in August—will help make the case for a cut in the base rate from 5.75% later this year. But it may not be enough to stop a wrenching slowdown after the financial shocks that have battered the economy. Mr Brown appears to have escaped this week's events unscathed, though his room for manoeuvre in calling the next election has been reduced. He is likely to pay a heavier political price in the months to come.

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Northern Ireland

In the footsteps of giants

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A row over alleged political favouritism roils the new government

WORTH seeing, but not worth going to see, was Dr Johnson's verdict three centuries ago. Yet the Giant's Causeway, with its odd geological formations and hexagonal rocks, is the biggest tourist draw in Northern Ireland. It is also the focus these days of a row over alleged party favouritism in the allocation of public works. Such spats, though unpleasant, are a reassuring sign that after decades of violence Ulster politics are slipping into a less threatening groove of perceived patronage and protest that is well-worn elsewhere.

In dispute is a new visitors' centre to welcome the 500,000 people who troop through each year, replacing one that burned down seven years ago. In 2005 an architect from Dublin, Roisin Heneghan, won a public competition with her design of buildings nestled into the landscape.

Those drawings are still on the website of Northern Ireland's Department of Enterprise, Trade and Investment (DETI), the centrepiece of a “tourism masterplan” to woo visitors to the beautiful north Antrim coast. But a projected cost of £14m (worth $28m today) has become £21.5m, and planning permission has not yet been granted.

When devolved government replaced direct rule in May, members of the Democratic Unionist Party (DUP) got the top jobs in DETI and the Environment Department. This month Nigel Dodds, the enterprise minister, and Arlene Foster, the minister for the environment, announced that Mr Dodds would stop spending money to convert the prize-winning design into builders' blueprints because Mrs Foster was “minded” to grant planning permission to a local businessman instead.

That businessman, it emerged, is Seymour Sweeney, a prominent developer and a DUP member. Mr Sweeney has wanted for years to build a new centre. Details of his design have not been made public but the outline is causing concern. Although he would pay for the centre himself (building it on land he owns adjacent to the site and running it commercially), many fret that it would not suit the natural setting half so well as Ms Heneghan's much-praised proposal.

Equally worrying to the anti-unionist Social Democratic and Labour Party (SDLP) and Sinn Fein are Mr Sweeney's DUP links, which they have probed repeatedly on the floor of the Assembly. Mr Sweeney says he has made no donations to the party. He confirmed that he had sold a holiday home in 2004 to Ian Paisley Junior, son of the DUP's leader and an Assembly member for North Antrim, but said it was at full market value. A spokeswoman suggested a “possible hiccough in the administration process” as the reason why the house is still registered in the name of Mr Sweeney's wife. Cosiness, not corruption, seems to be the issue.

Mrs Foster says she will sue anyone who impugns her integrity. Less pugnacious, Mr Dodds hedged his bets on September 18th, saying that he was not shelving the prize-winning proposal but putting it on hold while his colleague made her planning decision. In the time-honoured fashion of politicians on bigger stages, he tetchily denied a climb-down: he had simply been determined not to waste public money if private was available, he said.

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Playboy's London megastore

Playing it safe

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The world's most famous titillator has gone squeaky clean

SNUGGLING between a family chemist and a mobile-phone shop on London's busy Oxford Street is a slim, cream-coloured building. As workmen polish the discreet silver bunny sign, passers-by peer in to a world of chandeliers and purple velvet. Spanning 4,000 gloriously gaudy square feet, Playboy's new London store—its largest in the world—is scheduled to open on September 21st.

The three-storey emporium is the newest outpost in the Playboy empire, which began with a men's "lifestyle" magazine and now lends its brand to clothes, cosmetics and any knick-knack big enough to feature its rabbit-head logo. With its magazine sales down by 8% a year and advertising rates tumbling, the company is increasingly looking to its licensing operation, currently worth some $750m (£375m) a year worldwide and growing faster than any other part of the business.

Setting up in Britain is brave. In 2004 another American smut purveyor, Hustler, launched a 6,000-square-foot megastore in Birmingham, but closed a year later after losing £1.5m. Its limp performance was due to the shop's association with the "pretty hardcore" *Hustler* magazine, reckons Jacqueline Gold, head of Ann Summers, a 136-branch sex-shop chain. Sex sells in Britain, where the best-selling daily newspaper features a topless model on page three. But it must be subtle: Ann Summers is raunchy enough to have its adverts banned by the prudish London Underground, but sex-toys make up just 20% of its stock (which also means it does not require a sex-shop licence and thus has access to the high street).

Playboy is going even cleaner. The London store will not display the magazine, let alone sex toys. Stock is confined to gear for the home and clothes (pricey ones at that: frilly knickers for £50 and a £600 crystal-studded leather jacket top the bill). A spokeswoman lists Diesel, Urban Outfitters and Top Shop as likely competitors. Women are expected to make up 80% of customers.

Luxury labels have had the best of retail lately, boding well for Playboy's upmarket effort. And there are marketing benefits. "Large companies are starting to use the megashop as a window on the brand," says Nick Harrison of Oliver Wyman, a consultancy. Plenty will take a furtive peep at this one.

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The Liberal Democrats

Talking the talk

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Leftist rhetoric distracts from a move towards the centre

THE Liberal Democrats, often neglected by the media, got their own back at their annual conference in Brighton this week. Journalists decamping to the coastal town were looking forward to some of the internal strife that has made Britain's third party an intermittently rewarding beat in recent years: a leadership putsch, for example, or a showdown between the different strands of liberalism that sometimes make the party hard to handle. They had, instead, to get their heads around some serious bits of policy-making.

To be sure, there are grumbles about Sir Menzies Campbell, the party leader, who is prone to presentational gaffes and seems older than his 66 years. But there is little desire for a contest only 18 months after he replaced Charles Kennedy. Delegates also play down the ideological fault-line between the “Orange Bookers”, a group of mostly young MPs who are authors of a tome espousing economic as well as social liberalism, and more conventionally left-wing elements of the party. All political parties, they note, are uneasy coalitions.

And yet a divide of sorts did emerge in Brighton: that between the party's rhetoric, which is flirting heavily with the populist left, and its policies, most of which are assiduously centrist. On September 16th Sir Menzies lambasted the rich for having done “too well” under Labour. The following day Vince Cable, the party's Treasury spokesman, deplored Britain's generous tax treatment of internationally mobile wealth, labelling Gordon Brown the “patron saint of the super-rich”. After that Mr Kennedy reminded delegates that, when the party went into the last election promising to raise the top rate of income tax, it won its largest number of parliamentary seats for 80 years.

Such language is not without a tactical rationale: polls show that most Britons, including Tory voters, believe that the richest should pay more tax. And it may be the only way of retaining left-wing voters who defected to the party from Labour over the Iraq war at the last election.

But it also disguises the real drift of party policy, which is towards the middle ground. Having proposed an extra penny on the basic rate of income tax under Mr Kennedy, the Liberal Democrats now plan a four-pence cut. This would be offset by tax hikes elsewhere, especially on those who pollute: under Chris Huhne, their environment spokesman, the Lib Dems have become the first of the big parties to aim for a zero-carbon Britain. But the party's stomach for imposing heavier direct taxes on large sections of the electorate has gone.

Its line on public services—long criticised as mere demands for higher spending, and uncosted ones at that—is also starting to embrace market reforms. Norman Lamb, the party's health spokesman, wants to put more NHS funding into the hands of patients: pregnant women, for example, should be able to purchase care from independent midwives. David Laws, who holds the schools brief, insists that just pouring more money into the system won't help Britain's failing pupils.

Even on civil liberties, the issue which (along with the environment) most animates Liberal Democrats, there is a gap between rhetoric and policy. The conference's opening rally saw Sir Menzies share a platform with Shami Chakrabarti, head of a campaign group named Liberty, who used the opportunity to call Lord Carlile, the Lib Dem peer who reviews anti-terrorism laws for the government, a “public champion for internment”. The party's policy in this area is rather more pragmatic. Nick Clegg, the home-affairs spokesman, balances his opposition to extending detention without trial with ideas to bring suspects to court more quickly, and proposes a qualified rather than an absolute amnesty for illegal immigrants.

Some Orange Bookers admit that the left-wing tone various leading Lib Dems struck this week may have distracted attention from the serious work on policy. Not an incendiary revelation, but perhaps the closest journalists will get to an internal rift in the party anytime soon.

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Renewable energy

British sea power

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The government wants to build up a marine-energy industry

THE British have always looked to the sea to protect them from the earth's dangers. The ocean is a handy deterrent to foreign armies, but it is useful for other things too. In the midst of the energy crisis of the 1970s, there was much talk that marine energy would let its possessors break free of OPEC. With the arrival of North Sea oil, marine energy was forgotten. But 35 years later, with North Sea oil in decline, climate change a big issue and wind farms facing lengthy planning delays, sea power is back on the agenda.

On September 17th the government announced that planning permission had been given for Wave Hub, a £28m project off the north Cornish coast that will provide a sea-floor “socket” allowing wave-power generators to get their electricity back to shore. The South West Regional Development Agency (SWRDA), a quango which will part-fund the project, has high hopes. Four firms are planning to connect their machines, forming what officials hope will be the world's biggest wave farm, with 30 machines supplying up to 20 megawatts of power. An existing wave-power project in the Orkney islands is set to expand, and officials are studying a multi-billion-pound private-sector plan to harness the tides near the mouth of the river Severn.

Marine energy, and especially wave power, is still an immature technology. Many designs concentrate on surviving the fury of ocean storms rather than maximising energy production. Nor is it cheap. Firms are coy about giving precise figures but the Carbon Trust, a government-funded green consultancy, reckoned the price a year ago was between 22p and 25p per kilowatt hour—around nine times the price of gas-fired electricity.

Boosters argue that technology and mass production will bring costs down. British officials seem to agree. Having noticed the success of the Danes in developing their wind-turbine industry, both the SWRDA and the Scottish Executive want to do the same for ocean power.

Geography is one advantage: rough seas and big tides make the British isles one of the best places in the world for sea power. The Carbon Trust believes that, in theory, sea power could provide 20% of the country's electricity. There is engineering expertise, notably in Aberdeen, where the offshore oil industry has been installing complex machinery in rough seas for decades. The International Energy Agency thinks that Britain is pursuing more marine-power designs (29) than any other country (America, with 13, is second). Scotland already boasts the European Marine Energy Centre, a research outfit, an advantage the West Country hopes to counteract by spending £15m on a similar organisation attached to the universities of Exeter and Plymouth.

The economics are more complicated. David Weaver, the chief executive of Oceanlinx, one of the firms planning to use the Wave Hub, argues that Britain's liberalised and transparent power markets make life easier for newcomers, although others argue that fluctuating power prices make planning tricky. Subsidies are more generous in countries such as Portugal, which is keen on building a marine-power sector of its own and offers extra cash to less mature technologies.

Not everyone is enthusiastic. When the Wave Hub was announced, Cornish surfers worried that it might make their tubes less gnarly. Others are more concerned about the price. Mr Edge reckons that the Danes spent around £1 billion creating their wind-turbine industry. Setting up a British marine-power sector will cost a similar amount, he says—a big jump from the £28m Wave Hub.

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Buy-to-let firearms

Gun for hire

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The number of guns in Britain is stable, but they are circulating faster

Get article background

TRUNDLING around London this week was a transparent life-size prison cell, complete with bunk-bed and steel lavatory. The mobile jail was the latest attempt to remind teenagers of the grim fate that awaits those who dabble in guns, which have been used in a spate of youth killings this year. The murder in Liverpool last month of a boy of 11 focused minds: police called for witness anonymity in gun trials to encourage testimony and the government released more money to tackle firearms in the four cities where they cause the most harm. A new report on gun crime is expected next week from the Association of Chief Police Officers (ACPO).

According to Keith Bristow, ACPO's expert on the subject, Britain is not “awash” with guns, as some believe. Seizures of ancient firearms—including second world war-era revolvers—suggest that criminals have difficulty getting hold of decent weapons. Although there is a steady drip from abroad (often into Liverpool via Ireland, rumour has it), the police have been successful in cutting down on the theft of guns within Britain. The 1.4m legally registered shotguns—often kept in carelessly guarded farms—make easy pickings; 243 were reported misappropriated in the year to March 2006, down from 728 a decade earlier. The theft of other types of gun has fallen dramatically too. It is also harder to reactivate old weapons, thanks to a change in the law in 1995 requiring deactivated guns to be disabled more thoroughly (it might have worked better still had the law been made retrospective).

Yet for all the good work in keeping a lid on supply, crime involving guns has doubled in the past seven years (see chart). The biggest increase is in the use of replicas, capable only of firing a plastic pellet or lighting a cigarette. But crime using real guns has also risen, and in the same period the number of injuries by firearms (excluding airguns) has more than quadrupled.

Police think that the same guns are being used by more people. A weapon may be found at a shooting in Manchester and traced to earlier crimes in Birmingham and Leeds. The National Ballistics Intelligence Programme, a police database due to launch next April, will aim to keep track.

The gun merry-go-round is a product of the changing profile of the British gangster. “Professional” criminals—such as the bank robbers shot dead by police in Hampshire on September 13th—nearly always destroy a gun that has been fired, fearing forensic evidence. Today's teenage gangs are less careful: because of poverty or stupidity they tend to let or sell their used weapons. The result is that each gun gets more use.

Some have suggested that would-be thugs are renting guns to use as fashion accessories. Daniel Silverstone of Portsmouth University is sceptical: “It would be cheaper to buy a replica,” he points out. “Someone who hired a real gun would probably intend to use it.” Renters must either be very short of cash or in need of a gun at very short notice, he reckons.

Besides, the rental market ought to work the other way around. Since 2003 owning a gun has been punishable by a mandatory five-year jail sentence. The heightened risk means that some criminals rope in others to babysit their weapons. In one case cited by the Home Office, a person was paid £100 per week to take on the liability. If anyone is still paying to rent a gun, it may be time to renegotiate.

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Bagehot

The trailblazers

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From The Economist print edition

Illustration by Steve O'Brien

Why the Liberal Democrats are the party of the future

LIKE a big (but not that big) group of hostages, oscillating between hope of escape and fear, the mood of the Liberal Democrats at their conference in Brighton this week swung between gloom and elation. They were gloomy about their depressed poll ratings, and the erratic ones of their leader, Sir Menzies Campbell; they were intermittently elated by the glorious future predicted by their ideologues. “The tide of history is on our side!” they exhorted, and “The old politics are dead!” A lot of mean things can be and have been said about gentlemanly Sir Menzies and his party; but Bagehot proposes to pass over his lame jokes and calculating would-be heirs, the eccentric speeches and the sandals. Because the key thing about the Lib Dems is that they are almost certainly right. In two important ways, the tide of history and the evolving nature of politics are on their side—sort of.

One of the mini-controversies of the conference was over Sir Menzies's avowed enthusiasm for “hammering” the rich. Both the enthusiasm and the controversy arise from the heterogeneous nature of Liberal Democrat voters: they are a tense alliance of disillusioned lefties and well-meaning patricians, genuine liberals and holders of ancestral grudges against the other two parties. To keep this ragtag coalition together, the Lib Dems need to “narrowcast”—for example, by signalling a more redistributive attitude to taxation to voters in the Midlands without frightening the horsey types in southern marginals.

Narrowcasting is a tough trick, as David Cameron and his Conservative Party also learned recently, when they tried to allay misgivings among the Tory ultras without compromising their cuddly new centrist image. But it is increasingly a trick that all the main parties have to pull off—because the old politics *are* dying, as the Lib Dem ideologues insist.

This realignment may be a less dramatic shift than the decline of the Liberals after the first world war, but it is happening. The traditional politics of left and right, at least defined in terms of class and economics, is obsolescent. For the time being, familiar issues such as health and education are still salient. Tribal party loyalties, based on old class identities, still obtain: there are millions of Britons, in ex-industrial northern towns and patriotic suburbs, for whom voting for anyone other than Labour or the Tories is more or less unthinkable. But, like religious identities, those bonds are weakening, as the economy that created them is transformed. New political axes will come to rival, if not entirely replace, the old economic one: liberty versus security, say, or liberty versus environmentalism. The result will be that, even more than Tony Blair in pursuit of his 1997 landslide, parties will need to yoke together disparate coalitions of dissimilar voters in order to win elections.

Dream on

The second way in which the future of politics will look Liberal Democrat is how parties go about the yoking. Beneath the headlines about hammering—and beyond the mini-scandal of Sir Menzies's ill-advised photo-opportunity with an organic toilet—the Lib Dems, and especially the impressive triumvirate of Nick Clegg, David Laws and Chris Huhne, actually have quite a lot of sensible policies. They have authentically liberal and considered things to say about prisons and immigration; on using the courts rather than extra-judicial powers to punish terrorists; on the environment; and on educating disadvantaged children. But the sad truth is that, aside from their distinctive stance on Iraq, their popularity and their policies are only loosely related.

That is largely for reasons peculiar to them. Voters tend to take seriously only pledges that are likely to be implemented, which excludes those made by the Lib Dems. Many votes for them are really protests against their opponents: their recent poll doldrums have reflected Mr Cameron's early bounce, and latterly Gordon Brown's, more than their own performance. In these circumstances, as the worldlier Lib Dems admit, having policies is really a sort of irrational exuberance, mainly required to remind voters that they exist.

Quite apart from this third-party predicament, though, policy is a decreasingly important factor in politics generally—certainly compared with the genuinely ideological clashes of the 1980s. Part of the explanation for that trend is that Labour and the Tories now agree about so much, even if they conceal their similarity by narcissistically inflating small differences. Mr Brown's omnivorous pilfering of everyone else's best ideas is blurring the distinction more than ever (which hurts the Lib Dems, since this coalescence has made grumpy Labour and Tory voters readier to switch straight to the other big party). Part of it is the influence of digital media on how political opinions are formed. That has made having a charismatic and ideally photogenic leader vital (which is why some people have been beastly about Sir Menzies). Policy itself is becoming the aroma of politics, rather than its substance—as it already is for the Lib Dems.

In one respect, however, the Liberal Democrats are and will remain unique. Not only do their policies not determine their popularity: their popularity will not determine their chances of wielding power. For that they need a hung parliament after the next election, whenever it is; and for a hung parliament they need Labour to do badly. Since the Conservatives are second in most of Labour's marginal seats, that in turn depends mostly on the Tories doing better, rather than on the Lib Dems' own results. Unfortunately for them, probably only a reform of the voting system will alter that basic dependency—because even if the intellectual shape of politics changes, the institutional shape, based on the two great party machines, ruthless and adaptable, is likely to stay the same. The Lib Dems may have seen the political future, but that does not mean they will inherit it.

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Economist.com WORLD INTERNATIONAL

Religion and ecology

Faith upon the earth

Sep 20th 2007 | DELHI AND ILULISSAT, GREENLAND
From The Economist print edition

Daniel Heaf

In many parts of the world, religious groups and environmental scientists are teaming up—albeit sometimes reluctantly

“THERE was a functioning bridge until 1470 AD,” says Praveen Togadia, a Hindu fundamentalist, smoothing out his *dhoti*. “Due to natural calamities, it was disturbed, and parts went into the sea.” To modern, secular eyes, at least, the “bridge” is a 30-mile (48km) chain of sandy shoals across the Palk Strait between India and Sri Lanka. But millions of Hindus see the shoals as physical proof of their beliefs. The Ramayana, a Hindu text, says a bridge was built by monkeys at the behest of a Hindu god, Ram—who duly crossed over to wrest his wife Sita from a Sri Lankan demon. The shoals are known in India as “Ram Setu”, or “Ram's Bridge”.

Now take a deep breath and consider the conflict over a plan by India's Congress-led government to dredge the strait for a shipping canal. While Hindus loathe the project on spiritual grounds, ecologists have different objections. At the junction of the deep, cold Indian Ocean and the shallow, temperate Arabian Sea, the strait is an ecological prize. So far, 377 endemic species have been found in nearby waters.

On this issue at least, the devoutly religious and the greens are on the same side. But the former, it seems, have more clout than the latter. On September 12th the government told the Supreme Court that the Ramayana was not proof of the existence of Lord Ram; and that science suggested the shoals were made by sedimentation, not monkeys. On the same day, the World Hindu Council, headed by Dr Togadia, staged protests across the country. On September 14th the government, at the behest of Sonia Gandhi, the (Catholic) leader of Congress, put the canal plan on hold: a setback for a government which wanted to save ships from a 24-hour loop round Sri Lanka. With elections due next year, Congress feared giving its Hindu foes in the Bharatiya Janata Party a new slogan.

India's greens have little love for their accidental allies. “I'm not protesting against this project for religious reasons but for environmental ones,” says Kushal Pal Singh Yadav, of the Centre for Science and the Environment, a Delhi think-tank.

In many other parts of the world, secular greens and religious people find themselves on the same side of public debates: sometimes hesitantly, sometimes tactically, and sometimes fired by a sense that they have deep things in common.

One more case from India: ornithologists who want to save three species of vulture (endangered because cattle carcasses are tainted by chemicals) see their best ally as the Parsees, who on religious grounds use vultures to dispose of human corpses.

In China, organised religion is much weaker and conservationists also feel more lonely. But Pan Yue, the best-known advocate of green concerns within the Chinese government, says ancient creeds, like Taoism, offer the best hope of making people treat the earth more kindly.

Other tie-ups between faith and ecology are less obvious. In Sweden, the national Lutheran Church, working with Japanese Shintos, recently held a multi-faith meeting on forestry. They agreed to set a new standard for the care of forests owned or managed by religious bodies—in other words, they said, 5% of the world's woods.

This month, representatives of many faiths, including a local Lutheran bishop and a shivering Buddhist monk (see above) gathered in Greenland to talk to scientists and ecologists. Patriarch Bartholomew, the senior bishop of the Orthodox Church, led his impressively robed guests in a silent supplication for the planet.

The terms of the transaction between faith and ecology vary a lot. In places like Scandinavia, where religion is weakish, a cleric who “goes green” may reach a wider audience; in countries like India, where faith is powerful, spiritual messages touch more hearts than secular ones do. That doesn't stop some environmental scientists from saying they are being hijacked by clerics in search of relevance. But Mary Evelyn Tucker, of America's Yale University, says secular greens badly need their spiritual allies: “Religions provide a cultural integrity, a spiritual depth and moral force which secular approaches lack.”

Martin Palmer, of the British-based Alliance of Religions and Conservation, says faiths often have the clearest view of the social and economic aspects of an environmental problem. In Newfoundland, he notes, conservationists put curbs on cod fishing—and left the churches to care for families whose living was ruined.

Still, one selling point often used by the religious in their dialogue with science—the fact that faith encourages people to think long-term—may be a mixed blessing. The most pessimistic scientists say mankind has a decade at most to curb greenhouse gases and fend off disastrous global warming; that doesn't leave much time to settle the finer points of metaphysics.

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Terrorism and civil liberty

Is torture ever justified?

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Have the terrorist attacks of September 11th 2001 put a lasting dent in civil liberties? The first of a series begins this week with a look at torture

IN EVERY war, information is a weapon. In a “war against terrorism”, where the adversary wears no uniform and hides among the civilian population, information can matter even more. But does that mean that torture can sometimes be justified to extract information?

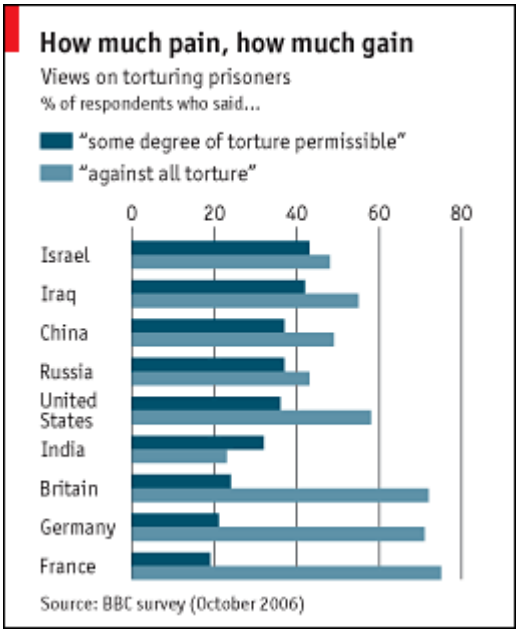
The answer in international law is categorical: no. As laid down in treaties such as the Geneva Conventions, the UN Convention against Torture and the International Covenant on Civil and Political Rights, the ban on torture or any cruel, inhuman or degrading treatment is absolute, even in times of war. Along with genocide, torture is the only crime that every state must punish, no matter who commits it or where. Defenders of this blanket prohibition offer arguments that range from the moral (torture degrades and corrupts the society that allows it) to the practical (people will say anything under torture so the information they provide is unreliable anyway).

The September 11th attacks have not driven any rich democracy to reverse itself and make torture legal. But they have encouraged the bending of definitions and the turning of blind eyes. There is a greater readiness among governments that would never practise torture themselves to use information which less squeamish states have obtained—through torture.

Start with definitions. Most civilised people squirm at the thought of putting suspected terrorists on the rack or pulling off toenails. What if that prisoner knew the whereabouts of a ticking bomb—maybe a biological, chemical or even nuclear one? Wouldn't a little sleep deprivation, sexual humiliation or even water-dunking be justified to save hundreds and perhaps thousands of lives? Whatever the law says, a lot of people seem to think so.

In a BBC survey of 27,000 people in 25 countries last October, more than one out of three people in nine of those countries, including America, considered a degree of torture acceptable if it saved lives. Opposition was highest in most European and English-speaking countries (see chart). Another poll in 2005 by the Pew Research Centre found that nearly half of all Americans thought the torture of suspected terrorists was sometimes justified.

Two Republican presidential hopefuls, Rudy Giuliani and Mitt Romney, support the “enhanced” interrogation of suspects in the event of an imminent attack. Dick Cheney, America's vice-president, recently suggested that “dunking” a terrorist in water to save lives was a “no-brainer”. The ensuing uproar led him to backtrack, claiming that he was not, of course, referring to “water-boarding”, or simulated drowning, a technique regarded as tantamount to torture and banned in the American army's own interrogation manual.



I'll tickle you into submission

One objection to allowing moderate physical pressure is the difficulty of knowing where to draw the line. If stress positions and sleep deprivation do not work, do you progress to branding with red-hot irons and beating to a pulp? And can you rely on interrogators to heed such distinctions? It is the danger of a slippery slope that makes opponents of torture insist on a total ban.

Israel is the only country in modern times to have openly allowed “moderate physical pressure” as a “last resort”. Since interrogators used such methods anyway, it was argued, passing an explicit law would at least make it possible to set out some limits. But in 1999, citing the slippery-slope argument, Israel's Supreme Court ruled that torture could never be justified, even in the case of a ticking bomb. It went on to outlaw techniques such as sleep deprivation, exposure to extremes of hot and cold, prolonged stress positions, hooding and violent shaking.

In the 1970s Britain used similar techniques against suspected terrorists in Northern Ireland. These were banned in 1978 following a case brought by the Republic of Ireland to the European Court of Human Rights. Although not torture, such methods did amount to inhumane treatment, the court ruled. In 2002 the International Criminal Court for ex-Yugoslavia in The Hague decided that prolonged solitary confinement constituted torture. Such rulings did not prevent America from resorting to such harsh techniques when interrogating suspects in Afghanistan, Iraq and Guantánamo Bay, however. Former detainees in those places have spoken of severe beatings, water-boarding, excruciating stress positions, mock executions, sleep deprivation and much else besides.

Administration lawyers argued that since al-Qaeda and its Taliban allies were not a state party to the Geneva Conventions they were not covered by its ban on torture and other maltreatment. True, America had ratified (in 1988) the Convention against Torture, but that applied only to acts carried out on American soil, they said. And though America's own 1994 federal statute against torture did cover acts by Americans abroad, this applied only to full-blown torture, not lesser abuses.

In the notorious “torture memos” drawn up by the Department of Justice and the Pentagon in 2002 and 2003, the same lawyers sought to restrict the normal definition of torture—“severe pain or suffering”—to extreme acts equivalent to “serious physical injury, organ failure, or even death”. Furthermore, as a wartime commander in chief whose main duty was to protect the American people, the president had the power to override both domestic and international law, they argued. After being leaked in 2004 most of these memos were “withdrawn”, though not the one on the president's wartime powers.

Mr Bush and his colleagues have always said that America neither authorises nor condones torture. “We don't do torture,” the president famously said. But Mr Bush has been vaguer about the grey area between torture and more moderate pressure. Soon after suspected terrorists were first sent to Guantánamo in January 2002 he said that America's armed forces would treat the detainees “humanely” in a manner “consistent with the Geneva Conventions”—but only “to the extent appropriate and consistent with military necessity”.

Not until the Supreme Court's ruling in *Hamdan* in 2006 did the administration accept that all detainees, wherever held, were protected by Common Article 3 of the Geneva Conventions, which bans all forms of cruel, inhuman or degrading treatment as well as torture. The 2005 Detainee Treatment Act, incorporating an amendment by Senator John McCain, already prohibited such treatment by American soldiers anywhere in the world. But it did not apply to the CIA.

Co-operating with torturers

Yet it is the CIA that has been responsible for the “extraordinary rendition” of suspects to clandestine prisons in third countries for “enhanced” interrogation (whether by that country's agents or the CIA itself) amounting at times, many suspect, to torture. The programme's existence was not officially confirmed until Mr Bush announced last year the transfer to Guantánamo of the last 14 “high-value” detainees then being held in so-called “black sites” around the world. Of some 100 suspected terrorists believed to have been “rendered” over the past six years, 39 remain unaccounted for, Human Rights Watch, a New York-based lobby, says.

In July this year Mr Bush set out new broad guidelines for interrogations under a resumed CIA programme. He says the newly authorised techniques now comply fully with the Geneva Conventions' ban on “outrages upon personal dignity, in particular humiliating and degrading treatment” as well as

torture. Even if true (which is hard to know because the details have not been disclosed), the programme itself with its enforced disappearances and black sites, which even the International Red Cross is not allowed to visit, violates basic tenets of international law.

Even if a country bans torture, how should it treat information that others have extracted this way? In 2004 Britain's Court of Appeal ruled that information acquired through torture was admissible as evidence in court. David Blunkett, then Britain's home secretary, welcomed the ruling. Although the government “unreservedly” condemned torture, he said, it would be “irresponsible not to take appropriate account of any information which could help protect national security and public safety.” But the ruling was later overturned by the House of Lords.

A separate question is whether governments should use information extracted under torture by others for counter-terrorist purposes, even if it is not admissible as evidence. Most probably agree with Mr Blunkett that it would be irresponsible not to. But a case can be made that this is, in effect, condoning the use of torture by allies.

Britain has also run into trouble when trying to deport suspected foreign terrorists against whom it has not got enough evidence to secure a conviction in court. Under international law, a country must make sure that the person it wishes to expel is not in danger of being tortured or subjected to other abuse in the receiving country. In 2005 the UN's special rapporteur on torture criticised Britain for relying on “diplomatic assurances” that deportees would not be tortured. Charles Clarke, who had succeeded Mr Blunkett as home secretary, retorted that the rights of the victims of the London Tube bombings that year mattered more than those of the perpetrators. The UN should “look at human rights in the round”, he said, “rather than simply focusing all the time on the terrorist.” Fine—except that no British court had convicted these suspects as terrorists.

To date, 144 countries have ratified the Convention against Torture. (The hold-outs include such usual suspects as Sudan, North Korea, Myanmar and Zimbabwe, but also India.) And yet, the UN's special rapporteur told the Security Council in June, torture remains widespread. Amnesty International noted cases of state-sponsored torture or other inhumane treatment in 102 of the 153 countries included in its 2007 report. The worst offenders were China, Egypt (both of which are parties to the convention), Myanmar and North Korea, along with several African countries. America's transgressions are trivial by comparison. The worry, argues Kenneth Roth, director of Human Rights Watch, is that when America breaks the rules it encourages others to do the same.

AP

The scandal of Abu Ghraib: a recruiting poster for terrorists

Why does torture endure? Part of the reason, argues Michael Ignatieff, a Canadian writer, may be that it is at times motivated not so much by a desire to extract vital information but by something baser, such as an urge to inflict pain, exact revenge, or even just for fun. That seems to have been part of the motivation of the Americans who abused prisoners in Abu Ghraib, for example. But torture may also endure because it sometimes works.

They'll say anything

Many critics of torture claim that it is ineffective as well as repugnant. Since people will say anything just to stop the pain, the information gleaned may not be reliable. On the other hand, if people do say anything under torture, you might expect some of what they say to be true and therefore—if those being

tortured really are terrorists—useful to the authorities. Torture certainly helped induce Guy Fawkes to betray his co-conspirators after they had tried to blow up King James I and the British Parliament on November 5th 1605.

Asked recently about the CIA's use of enhanced interrogation in secret prisons, George Tenet, the CIA's director until 2004, replied that the agency's widely condemned rendition programme had saved lives, disrupted plots and provided “invaluable” information in the war against terrorism. Indeed, while denying the use of full-blown torture, he said that the programme on its own was “worth more than the FBI, the CIA and the National Security Agency put together have been able to tell us.”

Mr Ignatieff, for his own part, sees no trumping argument on behalf of terrorists that makes their claims to human rights and dignity prevail over the security interests—and right to life—of the majority. Yet he continues to advocate a total ban. “We cannot torture, in other words, because of who we are,” he says. He knows that many will disagree.

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Microsoft

A matter of sovereignty

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Illustration by Claudio Munoz

What the European Court's ruling means for the technology industry

"YOU asked for it, now live with it." That was, in essence, the message spread by Microsoft's lobbyists after the European Court of First Instance upheld a landmark antitrust ruling against the world's largest software firm on September 17th, dealing it the most stinging defeat in nearly a decade of antitrust litigation. Emboldened by this decision, Europe's anti-monopoly squad will now go after other technology firms with high market shares, the lobbyists warn, forcing them to give up valuable intellectual property and curbing the incentive to innovate.

Yet it is unlikely that that Neelie Kroes, the European Union (EU) competition commissioner, will now "be leading a prison march of the world's most successful firms through her Brussels doors", as one lobbyist put it. The judgment's consequences are far-reaching, but in a different way. If it is not overturned—as *The Economist* went to press, Microsoft had not said whether it would make a final appeal—the firm will, in effect, lose much of its sovereignty over the virtual territory staked out by its Windows operating system.

Microsoft ended up in the dock in both Europe and America because it tried to protect and extend its Windows monopoly in two ways. One was by bundling other types of software along with Windows, notably its web browser, a move that triggered the antitrust action in America. Its other approach, which lay at the heart of the European case, was to withhold information from rivals that would have allowed their software to "interoperate" well with Windows over a network.

With a new Republican president in power, America's competition authorities decided in 2002 not to pursue the case championed by the Clinton White House and instead negotiated a settlement with Microsoft. This "consent decree", large parts of which will expire in November, amounted to little more than a slap on the wrist. It failed to administer any penalty and let Microsoft add new software elements to Windows so long as PC-makers were allowed to add rival products too. The provision regarding interoperability was also limited: the requirement to provide the necessary "communication protocols" applied only to the version of Windows that runs on individual PCs, and not the one running on the servers that dish up data on corporate networks.

The European Commission's initial ruling against Microsoft in 2004 can be seen as an attempt to address these shortcomings. The commission ordered Microsoft to sell a version of Windows without its media-player software, the bone of contention in Europe when it comes to bundling. It ruled that the firm had to provide information on how to interoperate with Windows servers. The commission also imposed a fine of €497m ($613m), which has since grown to €777m ($990m) because it determined that Microsoft was not fully complying with its decision.

The European court has now upheld these remedies. Even more importantly, it largely endorsed the

commission's legal reasoning. It argued, for instance, that withholding information that is needed for PCs and servers to work together constitutes an abuse of a dominant position if it keeps others from developing rival software for which there is potential consumer demand. In such cases, the information cannot be refused even if it is protected by intellectual-property rights, as Microsoft had argued.

With its ruling, the court has set a precedent that means Windows is no longer simply private property with which Microsoft can do as it pleases. And this will certainly apply to any other firm that manages to build a similarly crucial and long-lasting digital monopoly. Even today, with software increasingly delivered as a service over the internet, Windows is protected by something known as the “application barrier to entry”, meaning that so many programs run on it that rivals have a hard time getting users and software developers to switch.

Yet, whatever the lobbyists say, European regulators are unlikely to go after every technology firm with a big market share. There are not many similarly dominant computer platforms. What is more, most of the potential investigations that may follow are different in kind from the action against Microsoft. In the case of Qualcomm, for instance, competitors have complained that it is charging excessive royalties for its patents on mobile-phone technologies. In the case of Apple, commission officials have already said that they are wary of proposals to force the firm to open iTunes, its online music store, to music-players other than its iPod; a separate investigation into iTunes concerns variations in pricing between European countries, rather than technological lock-in. Even the continuing investigation of Intel is not directly comparable to the Microsoft case. The world's biggest chipmaker, the commission charges, has used abusive tactics such as offering rebates to prevent computer-makers from using chips made by its rival, AMD.

For the time being, the commission can apply the precedents set by the Microsoft ruling in only one case: Google, the world's leading web-search and online-advertising firm. Just as America's Federal Trade Commission is now doing, the EU's competition authorities will look closely at Google's planned takeover of DoubleClick, another leader in online advertising. And if Google becomes a central storage vault for data such as users' location and identity, as some fear, European regulators may one day try to compel the firm to give rivals open access to this information—rather as they have now forced Microsoft to release its communication protocols.

Microsoft itself is not out of legal trouble, even if it chooses not to appeal. The commission has yet to determine whether the information the firm has supplied will really ensure interoperability. Still open, too, is the issue of how much Microsoft can charge firms that want to license its protocols. Then there is the question of whether Microsoft should be forced to license the information to makers of open-source software. The firm argues that this would be tantamount to giving away the shop, but the commission thinks it would promote competition by advancing open-source rivals to Microsoft's products. And further investigations may yet follow into Office, Microsoft's dominant suite of business software, and Vista, the latest version of Windows.

No wonder Microsoft is stoking fears that the commission plans to go on an antitrust rampage. It has prompted a political backlash that may discourage the EU from staying on the case. In America the talk is of a “new form of protectionism”. After the European court's decision Thomas Barnett, the head of the antitrust division of the Department of Justice, warned that it “may have the unfortunate consequence of harming consumers by chilling innovation and discouraging competition”.

With this judgment Europe and America have clearly moved further apart in antitrust matters. But whether, as some fear, these differences turn into a full-blown transatlantic conflict remains to be seen. After all, the administration in Washington will probably have changed several more times before the Microsoft case finally draws to a close.

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Climate change

Heavy weather

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From The Economist print edition

Firms are coming under increasing pressure to say more about global warming

EARLIER this year an outfit called the Carbon Disclosure Project sent letters to 2,400 big firms around the world, asking them what they were doing about climate change and how big their emissions of greenhouse gases were. The inquiry presumably carried some weight, since it was signed by 315 institutional investors, with roughly $40 trillion at their disposal. The resulting report, the fifth of its kind, which will be published on September 24th, suggests that ever more firms are taking climate change seriously, and a growing number are trying to measure emissions. “The gap between climate concern and action continues to narrow,” it concludes.

But not everyone is happy with the pace of change. On September 18th a group of investors and NGOs petitioned the Securities and Exchange Commission, America's stockmarket regulator, to clarify whether firms had an obligation under existing rules to disclose how climate change might affect them. The petitioners, who include officials from 11 American state governments, argue that firms should be telling investors more because both global warming, and regulations designed to curb it, could have a “material” (ie, big) impact on profits.

Mario Cuomo, New York's attorney-general, agrees. Two days earlier he began an investigation of five American energy firms he suspects of withholding information from shareholders about the risks associated with plans to build carbon-intensive coal-fired power plants, despite the likelihood of emissions curbs. Activists have also been asking companies how they will cope with climate change: 43 resolutions were introduced to the shareholders' meetings of American firms this year, according to the Investor Network on Climate Risk, a coalition of green investors. A motion calling for Exxon Mobil, an American oil giant, to set targets for emissions cuts, won the approval of 31% of shareholders. Faced with a similar proposal, managers at ConocoPhillips, another oil firm, agreed to set targets and to back a law to limit America's emissions. You could call it a change in the weather.

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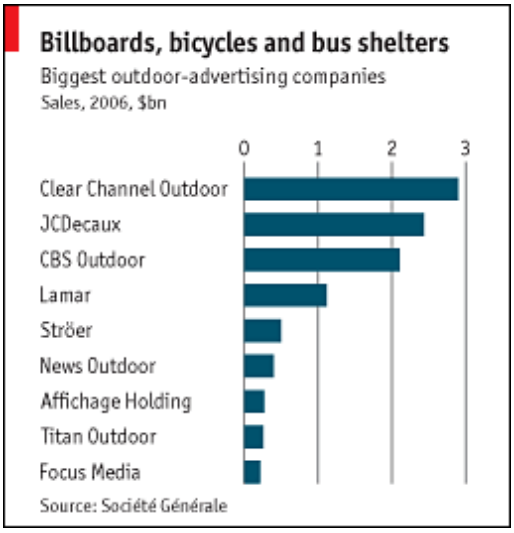
Outdoor advertising

Vive la Vélorution!

Sep 20th 2007
From The Economist print edition

JCDecaux and Clear Channel Outdoor battle over urban bike-schemes



OUTDOOR advertising has become fiercely competitive and highly political. America's Clear Channel Outdoor and France's JCDecaux fought for months in negotiations with the office of the mayor of Paris, and in court, to snap up the contract for *panneaux contre vélos*—setting up a bicycle-rental scheme in Paris in exchange for exclusive rights to the French capital's 1,628 billboards. Although Clear Channel claims to have won "technically", the French firm, whose founder, Jean-Claude Decaux, has close ties to the political establishment, emerged as the victor in practice this spring. JCDecaux set up the bike-rental system in record time and launched it on July 15th.

Vélib' (for *vélo*, or bicycle, and *liberté*, or freedom) has since taken Paris by storm. More than 10,000 bikes have been installed at 750 docking stations, which is half of the scheme's eventual capacity, says Jean-François Decaux, the son of the founder and co-chief executive of the family-controlled firm along with his brother, Jean-Charles. The bicycles have been used by 4m people so far, who have clocked up 100,000 rides a day. Last week Jean-François was in Moscow for talks with the mayor, who is keen to introduce a similar scheme there. The mayor of Chicago also expressed interest in importing Vélib' during a recent visit to Paris.

JCDecaux neither invented nor pioneered urban bike-operations. But Vélib' is on a different scale from any of its predecessors. Smaller schemes launched over the past four decades mostly failed because the bikes were vandalised or stolen. More recently both JCDecaux and Clear Channel Outdoor have launched urban bike-rental schemes in which users pay with their credit cards—which means they can be tracked down in case of abuse. Such schemes are now working well in more than a dozen cities including Vienna, Lyon, Brussels, Seville and Cordoba (run by the French), and Barcelona, Oslo, Stockholm and Rennes (run by the Americans).

Not all bike-rental operations are funded in the same way. The Paris scheme is entirely financed by JCDecaux, which is counting on rental fees and the sale of billboard advertising to cover its running costs and recoup the €90m ($126m) investment required to set it up. (A one-day pass for Vélib' costs €1, a weekly pass costs €5 and an annual subscription costs €29 with no additional charge as long as each ride lasts less than 30 minutes. Users also agree to a €150 security deposit.) The city of Barcelona, by contrast, pays Clear Channel Outdoor to run its "Cyclocity" scheme and pockets the rental fees. It is another success, with a 3,000-strong bike fleet that will increase to 6,000 by March next year. It already has 90,000 registered users who pay a €24 annual subscription.

JCDecaux and Clear Channel Outdoor will continue to compete for new bike schemes as well as contracts for billboards, street furniture (public loos, bus shelters and the like) and transport (advertising in airports and train stations). The French recently won a bike contract in Toulouse, and the American firm will launch a cycling scheme next month in Washington, DC. Both are lobbying hard for the right to set up a scheme in London.

In the past JCDecaux has repeatedly been accused of unfair play and Jean-Claude has twice been convicted of criminal offences in connection with contracts awarded by local governments. Both offences took place before the firm floated on the Paris stock exchange in 2001. Since then it seems to have played by the rules.

And now, with Jean-Claude's blessing, Jean-François and Jean-Charles (as well as Jean-Sébastian, a

younger son, and a few more Jean-hyphens involved in the management of the company) could be on the verge of the biggest coup in the firm's 43-year history. On September 25th shareholders are expected to approve the leveraged buy-out by two private-equity companies of Clear Channel, the media company that owns Clear Channel Outdoor, at a shareholder meeting in San Antonio, Texas. If the private-equity buyers then put the outdoor-ad business up for sale, the French are likely to jump on it.

A merger of Clear Channel Outdoor and JCDecaux would make lots of sense, says Edouard Camblain, an analyst at Société Générale in Paris. JCDecaux is weak in America, where Clear Channel has 22% of the market. Clear Channel is also appealing thanks to its strength in China, one of the world's fastest-growing markets. And a merger would bring considerable economies of scale.

Yet buying Clear Channel Outdoor would not be easy. The takeover would probably be paid for with a combination of debt, new equity and possibly the sale of the JCDecaux's 10.5% stake in Bouygues Telecom. This would dilute the stake held by the family, which holds 72% of the capital, and some of the hyphenated Jeans would probably have to go. Combining the market leaders might also cause problems with competition watchdogs in Britain and in France, where the merged firm's market share in outdoor advertising would be almost two-thirds—and it would be the only advertising company providing trendy urban-bicycle schemes.

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Business in China

Talent arbitrage

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From The Economist print edition

Can China continue to provide low-cost labour in high-tech industries?

Get article background

EVEN in the overheated world of Chinese initial public offerings, the listing and subsequent ballooning of the shares in WuXi PharmaTech has drawn gasps. It began trading on the New York Stock Exchange on August 9th at $14 a share, and the price has since doubled, giving it a market value of $1.65 billion. It would be hard to exaggerate the enthusiasm this suggests: in 2006 WuXi's revenues were only $70m, and its profits $9m.

The market's gusto has three causes. The most obvious is the vertiginous pattern of WuXi's financial performance, albeit from a low base. Revenues grew from $21m in 2004 to $34m in 2005, doubled last year, and may do so again this year. A second cause is the firm's business model. Successful Chinese companies typically have a stake in a government-constrained oligopoly (banks or mobile phones) or a basic industry such as property, steel, or mining. WuXi, by contrast, provides outsourced research for most of the world's big drug companies. It illustrates how China is evolving from producing basic products to sophisticated ones.

Hence the third cause for enthusiasm. China is thought to be an ideal spot for this sort of business. It is not fussy about animal testing unlike, say, India; the government is enthusiastic (providing tax and land incentives, plus the likelihood of intellectual-property protection); and, as in so many other industries in China, labour is cheap. Starting salaries for a PhD are $23,000 a year, compared with $200,000 a year in America, according to UBS, an investment bank. For a big drugs firm, WuXi offers a flexible outsourcing partner that is cheap to use and easy to dump: WuXi's contracts can be cancelled with as little as 30 days' notice.

But is this model sustainable? There are hints of problems to come. WuXi trades on the New York Stock Exchange through an odd depository share tied to a Cayman incorporation. The accounting is a bit odd, but in the initial regulatory filing there is a brief note explaining that profits were cut in half by a share-based compensation plan. That plan is projected to end soon, but another will surely take its place, because compensation costs in China are rising, particularly for firms that employ people whose talents are in demand around the world. WuXi's staff has grown eight-fold since 2003; at the end of May it had 2,000 employees and planned to hire many more. Demand for labour is almost certainly rising faster than supply, so sought-after employees are beginning to demand employment guarantees—and if WuXi and similar firms have to provide them, they will no longer be able to allow their customers to bail out at short notice.

Furthermore, there are questions about the suitability of the outsourcing model in fields such as pharmaceuticals. Companies in the industry are finicky. Quality must be consistently high and the work often involves strict secrecy, all of which argues for keeping it in-house. Recognising China's evolution, several drugs giants have set up their own Chinese operations, but they stress that the quality of employees, not cost, is the main reason, at least in the long term. WuXi may, of course, justify the market's confidence. If it does not, its investors will obviously be aggrieved, but that will not necessarily be bad news for its potential employees, or even for China. It will merely reflect how a glaring inefficiency in the market for world-class talent will have disappeared.

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Twenty20 cricket

India's innings

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A new form of cricket sparks a fight over a lucrative market in India

SNEERING cricket purists call it “hit and giggle”. But “Twenty20”, a new three-hour version of the elegant and at times seemingly interminable game, is serious business. In South Africa the inaugural Twenty20 world tournament, at which the top 12 cricket-playing countries are represented, is playing to sell-out crowds. It is accompanied by American-style razzmatazz previously unseen in cricket: feverish commentary, drumming dance music, scantily clad cheerleaders and all. And away from the stadiums, another contest is raging—to bring Twenty20 cricket to India, the world's biggest cricket market.

On September 13th the Board of Control for Cricket in India (BCCI), which claims a monopoly on the game in the country, unveiled plans for a Twenty20 cricket league, the India Premier League (IPL). Modelled on England's football league, it will involve eight teams, based in big cities and privately owned through a franchise agreement with the BCCI. This was the BCCI's response to the formation of a rebel Twenty20 league, the India Cricket League (ICL), by the Essel Group, an Indian conglomerate, earlier this year.

Reuters

Another six?

There is much to fight over. Cricket is the single shared passion of over a billion people in India, and another 350m across South Asia. Games between India's and Pakistan's national teams draw 400m television viewers in India alone. This brings in vast revenues. In 2005 the BCCI generated around $50m, mostly from broadcasting rights. This year it will turn over some $300m. And that is before it feels the effects of Twenty20, which could be seismic.

The new format is a revolution in brevity, designed for television. In a Twenty20 game each team bowls 20 overs—each consisting of six deliveries, the cricket equivalent of a baseball pitch—at the opponent's batsmen. By contrast, one-day cricket, the established short form of the game, is usually 50 overs a side. And test-match cricket, the marathon worshipped by purists, is not limited by overs at all. Each game lasts a maximum of five days.

The short format is more spectacular. It encourages batsmen to hit the ball out of the ground for a six, which spectators love. At the halfway mark, the Twenty20 tournament in South Africa averaged eight sixes per three-hour game. By comparison, a series of five test-matches between England and Australia in 2005, rated the most exciting in a 130-year rivalry, averaged less than two sixes a day.

In England, where it was first introduced in 2003, Twenty20 has resuscitated a moribund domestic game, packing stadiums on summer evenings. Similar results in Australia and South Africa led to the new tournament in South Africa. Over the next eight years this contest will earn cricket's governing body, the International Cricket Council (ICC), $1.5 billion from television rights alone. Indian broadcasters charge up to 400,000 rupees ($10,000) for a ten-second advertising slot during coverage of the Indian team's games.

Hence the attempted putsch by the Essel Group, which owns a television channel, Zee TV. It plans to invest $40m a year in its rebel league, the ICL, and expects it to be profitable within three years. Last month the ICL unveiled 51 players, including several foreign stars, who have been signed up on contracts said to be worth up to $500,000 a year. The league is scheduled to start play in November with a month-long tournament, featuring six teams and a prize of $1m. According to Kapil Dev, the former cricket star who runs it: “This game is fast, it's exciting, it can go to America, it can go to China.”

But not with the ICL, if India's cricket board can help it. The BCCI has banned the ICL's Indian players for

life. The league's foreign stars also face bans, though cricket's international governing body, the ICC, may hope that the BCCI's recently announced plans will convince them to renege on their rebel contracts. The official IPL will feature 59 games, over six weeks, starting next April. The winning team will receive prize money of $3m, and the top two teams will take on the best Twenty20 teams from England, Australia and South Africa. The winner of that tournament, which is likely to be held in Dubai in October 2008, will collect $5m.

Already the BCCI claims to have had enquiries from 40-odd people and companies interested in buying a ten-year franchise on an IPL team. The BCCI expects the franchises, which will be tradable, to be sold at auction for $50m-60m. For this sum, team owners will collect 70% of the IPL's main revenues. They will also be free to hire the players, Indian or foreign, of their choice. Lalit Modi, the IPL's chairman, predicts that the best of these—including Shane Warne, an Australian spin-bowler whom the IPL has already retained—will earn up to $1m a year.

That Twenty20 has a bright future in India is scarcely in doubt. Indian cricket fans are not purists; they like the shorter forms of cricket. Moreover, Twenty20 is especially popular with the young people whose attention advertisers crave. Nonetheless, the new Twenty20 leagues are gambles, because Indians have hitherto shown almost no interest in domestic cricket. “Cricket in this country is very heavily intertwined with national pride and emotion,” says Uday Shankar, boss of another television channel, Star TV. Until it is proved that domestic Twenty20 can generate the sort of following that international cricket does, he says, broadcasters and advertisers will be wary of it.

This could benefit the ICL, which is owned by a broadcaster. But the BCCI can frustrate its upstart rival by in effect denying it access to stadiums and players. “They're going to find it hard to get the cattle,” says Gideon Haigh, a cricket historian. Yet one way or another, Twenty20 will prosper, he believes. “It's about crowds. It's about television,” he says. “This is where the action is in international cricket.”

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Face value

The brand of Clinton

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AFP

How Bill Clinton became a leading brand in the giving industry

ANYONE who thought that his wife's run for the presidency would cause Bill Clinton to avoid the limelight has been proved utterly wrong. September began with the publication of the former president's book, “Giving”, about “how each of us can change the world”, and will end next week as he takes centre stage at a celebration of philanthropy self-effacingly called the Clinton Global Initiative (CGI). There is no stopping the man once nicknamed the “comeback kid”. Having left the White House under something of a cloud, he has since transformed himself into one of the hottest brands in the booming business of giving away money.

This is a remarkable piece of rebranding, to say the least, for a man never blessed with spare cash to give. “I entered the White House with the lowest net worth of any president in the 20th century, and I left it $10m-12m in debt,” Mr Clinton says. Speaking fees have helped of late, but only a bit. His genius has been to get other people to attach his name to their money—like a sort of philanthropic version of Donald Trump—to increase its impact.

As with Mr Trump, the Clinton brand is not to everyone's taste. But it is proving valuable in the philanthropic world. Distance from office restores and even adds to the lustre. So does distance from home: the Clinton name is probably strongest abroad, not least in places such as Africa where the need for philanthropy is arguably greatest. Many people, especially business leaders, love to be pictured with the former president, perhaps hoping that some of his charisma will rub off on them. Powerful people take his calls. And his famous wonkiness may enable philanthropists to find more effective ways to give money.

The impact of the Clinton brand has been increased considerably by its institutionalisation in the Clinton Foundation. Despite its name, this is really a non-governmental organisation, not a classic grant-making foundation, though there are plans to raise an endowment. It takes to a new level the post-presidential activism pioneered by Jimmy Carter—though the Carter brand occupies a specialist niche by comparison with the Clinton brand's mass-market appeal. Founded in 1997 to oversee the building of the Clinton Presidential Library, the foundation is now a global organisation that both runs programmes in areas such as fighting HIV/AIDS, poverty and climate change, and also helps other philanthropists develop programmes of their own.

Mr Clinton has not reinvented philanthropy, as some claim, but he does espouse a businesslike approach to giving money that is now fashionable among the new rich. He calls these philanthropists “bleeding-heart cheapskates”: they are “not naive, they don't want to waste a lot of money, they like low

administrative overhead, they measure pretty ruthlessly for return.”

Mr Clinton's greatest success so far has been cutting the price of anti-retroviral drugs for AIDS victims in poor countries. This involved negotiating bulk-purchase agreements with generic drugmakers. Although critics say that an arrangement of this sort was on the cards before Mr Clinton got involved, at the very least he accelerated it, benefiting many people. Now he is trying to repeat this trick to mitigate climate change by co-ordinating bulk-purchase agreements between the governments of some of the world's biggest cities and makers of low-energy products.

Partnership is the essence of brand Clinton. Anti-retrovirals are supplied to poor children jointly with the Children's Investment Fund Foundation of Chris Hohn, a hedge-fund boss. In 2006 the Clinton Hunter Development Initiative to promote sustainable growth in Africa launched with $100m from Sir Tom Hunter, a British billionaire. This year brought the Clinton Giustra Sustainable Growth Initiative to create alternative jobs in mining communities: $100m from Frank Giustra, a mining mogul, inspired matching sums from Lukas Lundin and Carlos Slim of Mexico, the world's richest man. “This ought to be a multi-billion-dollar effort,” says Mr Clinton. “Twenty-four other mining firms want to contribute, so this could get very big in a hurry.”

The CGI, a sort of “Philanthropy Oscars” launched in 2005, is Mr Clinton's annual pulpit to evangelise a philanthropic boom that he says is still only in its early stages. The CGI's 1,000 participants—65% from business—must pledge some good work, which they must accomplish or show progress towards, if they are to be invited back. Most honour their pledges, Mr Clinton insists, though it is hard to be sure since there is no naming and shaming. He says that 14 people were not allowed back last year.

Who profits?

One controversial aspect of the CGI is that many of the pledges—according to the foundation there have been nearly 600 so far, worth almost $10 billion—are to do things that boost the profits of the companies concerned, such as Wal-Mart. In his recent book, “Supercapitalism”, Robert Reich, Mr Clinton's labour secretary, attacked his old boss for praising firms for doing what is in their self-interest. Mr Clinton concedes that this raises tricky questions, but says he will highlight a for-profit pledge if it is likely to generate significant public good. “If Wal-Mart really does sell 100m compact fluorescent bulbs and people buy them, and screw them in, and use them, it will have the CO_2 impact of taking 700,000 cars off the road,” he says.

Mr Clinton insists he will continue his philanthropic work even if he becomes First Spouse—though some things would have to change. In particular, he would have to be more transparent. “Now we don't have to publish all of our donors, for example, and if Hillary became president, I think there would be all these questions about whether people would try to win favour with her by giving money to me,” he says. “You know it wouldn't work, and I don't think they would. Still, there are legitimate questions.” But given the power of Mr Clinton's personal brand, that transparency may be a price worth paying.

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Securitisation

When it goes wrong...

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Reuters

A generation has prospered from the wholesale transfer of risk through securitisation. Now it is paying the price

“THE medium-term outlook for the company is very positive,” declared Northern Rock's chief executive, Adam Applegarth, unveiling its first-half results in July. He spoke of a credit book that was “robust”. Who would have guessed that less than two months later Britain's fifth-largest mortgage lender would be fighting for its life, its branches besieged by customers demanding their savings back?

The run on Northern Rock is the most dramatic symptom of the contagion gripping the financial markets. Here was a bank that had grown rich from the innovations of recent years, using abundantly stocked wholesale markets to fund its lively growth, using those same markets to offload bits of its loan book as and when they became unattractive.

But the very innovations on which Northern Rock thrived have savaged its business. The company does no lending to speak of overseas. Nevertheless, its fate was determined by the distant turmoil in America's mortgage market. When that spilled over into the securities markets, the money markets that Northern Rock had depended on for years dried up in a single day at the start of August.

The brave new world that enabled banks like Northern Rock to grow so fast is founded on “securitisation”—the process that transforms mortgages, credit-card receivables and other financial assets into marketable securities—and the innovation it spawned in “structured” products. This was a revolution that brought huge gains. But across the financial world investors and regulators are asking themselves whether it also brought costs that are only now becoming clear.

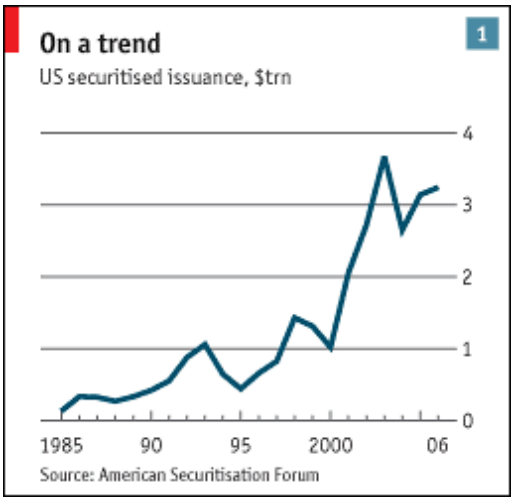
Investigations begin

In America the President's Working Group on Financial Markets, which includes the Federal Reserve and the Treasury, has launched a probe into securitisation and the rating agencies, which monitor it. IOSCO, a global regulators' body, has begun an investigation of its own. And the two biggest securitisation clubs on either side of the Atlantic held an emergency summit this week to look for ways to coax investors back into moribund asset-backed markets.

It is hard to overstate the extent of this reversal in fortunes, if only because it is hard to overstate the effect that securitisation has had on financial markets. Until the early 1980s, finance hewed to an

“originate and hold” model. Banks generally held loans on their balance sheets to maturity; some debts were sold on loan-by-loan, but this market was small and lumpy. This began to give way to an “originate and distribute” model after America's government-sponsored mortgage giants issued the first bonds with payments tied to the cash flows from large pools of loans.

Wall Street built on this innovation, and securitisation took off soon after, then paused before exploding in the 1990s (see chart 1). It was given a lift by America's savings-and-loan crisis, which encouraged mortgage lenders to jettison their riskier loans, and by new technologies, such as credit-scoring, that facilitated loan-pooling. Around 56% of America's outstanding residential mortgages were packaged in this way, including more than two-thirds of the subprime loans issued in 2006. Thanks largely to securitisation, global private-debt securities are now far bigger than stockmarkets.



Banks have come to see securitisation as an indispensable tool (see chart 2). Global lenders use it to manage their balance sheets, since selling loans frees up capital for new business or for return to shareholders. Small regional banks benefit too. Gone are the days when they had no choice but to place concentrated bets on local housing markets or industry. Now they can offload credits to far-away investors such as insurers and hedge funds, which have an appetite for them.

Michael Milken, of junk-bond fame, called securitisation the “democratisation of capital”. Studies suggest that the explosion of this “secondary” market for bank debt has helped to push down borrowing costs for consumers and companies alike. There are other “systemic” gains, too. Subjecting bank loans to valuation by capital markets encourages the efficient use of capital. And the broad distribution of credit risk reduces the risk of any one holder going bust.

Even in the midst of turmoil, it is hard to find a banker, regulator or academic who wants to see the clock turned back. But the crisis has exposed cracks in the new model that were hidden or ignored during the credit bubble. The three most glaring are complexity and confusion, a fragmentation of responsibility and the gaming of the regulatory system. Take each in turn.

Too clever by 50 basis points

The past few weeks have shown that financiers did not fully understand what they were trading. The boom in derivatives was one of those moments when financial engineering raced ahead of back offices and risk-management departments, leaving them struggling to value or account for their holdings. Pierre Pourquery, of Boston Consulting Group, says it is not uncommon for investors to break their exotic purchases into smaller pieces in order to feed them into their risk-management systems. This brings new risks, particularly that the parts will behave differently from the whole under stress.

Steven Schwarcz, a professor at Duke University and writer on securitisation, has come across contracts which are so convoluted that it would be impractical for investors to try to understand them: they would have to spend more money hiring experts to deconstruct them than they could ever hope to earn in extra returns.

In a recent paper* on credit derivatives, David Skeel and Frank Partnoy concluded that collateralised debt obligations (CDOs), one of the most common derivatives, are too clever by half. The transaction costs are high, the benefits questionable. They conclude that CDOs are being used to transform existing debt instruments that are accurately priced into new ones that are overvalued.

Complexity confuses investors about the risks they are taking on. The more eclectic CDOs bind together the fate of assets that have few real economic links. Imagine a lowly rated energy bond and top-notch bank paper in the same structure. Separately, they would not normally move in tandem. Put them in a CDO, however, and in a credit squeeze they fall together, by virtue of being in the same murky structure,

as investors rush for the exit or seek to hedge their risks.

The lack of transparency plagues the bundling of loans into securities, too. These days, for instance, lenders are less likely to foreclose on defaulting borrowers: in America, less than a quarter of loans 90 days late or more are in foreclosure, compared with three-quarters in the late 1990s, points out Charles Calomiris, of Columbia University. When a late payer gets back on track his loan is once again labelled “current”, and his chequered history does not have to be fully disclosed when the loan goes into a securitised pool. So even the most diligent buyer would struggle to spot that some of the “prime” collateral of mortgage-backed bonds was, in fact, of questionable quality.

Investors seeking redress have encountered unforeseen problems. Securitisations are generally structured as “true sales”: the seller wipes its hands of the risk. In practice buyers have some protection. Many contracts allow them to hand back loan pools that sour surprisingly quickly. Some have done just this with the most rancid subprime mortgages, requesting an injection of better-quality loans into the pool. But there were so many bad loans that originators could not oblige. “What we thought was an effective secondary-market punishment mechanism turns out to be faulty when the problem grows beyond a certain size,” says Anthony Sanders, a subprime expert.

The second lesson of the past few weeks is that securitisation has warped financiers' incentives. It is sometimes portrayed as bank “disintermediation”, but in fact it replaces one middleman with several. In mortgage securitisation, for instance, the lender is supplanted by the broker, the loan originator, the servicer (who collects payments), the investor and the arranger, not to mention the rating agencies and mortgage-bond insurers.

This creates what economists call a principal-agent problem. The loan originator has little incentive to vet borrowers carefully because it knows the risk will soon be off its books. The ultimate holder of the risk, the investor, has more reason to care but owns a complex product and is too far down the chain for monitoring to work. For all its flaws, the old bank model resolved the incentives in a simple way. Because loans were kept in-house, banks had every reason both to underwrite cautiously and also to keep tabs on the borrower after the money left the vault.

Investors in loan-backed securities could have pushed for tougher monitoring. But most were too taken with the alluring yields on offer—an addiction Alan Greenspan, the Fed's former chairman, has likened to cocaine abuse. Debt investors are usually sober types, but as the bubble grew, it was increasingly their urges, and not the creditworthiness of homeowners, that determined loan-underwriting standards.

Wall Street took full advantage of this appetite. It was well known that investors such as Germany's IKB, a lender to small companies which was bailed out last month, had a weakness for exotic products. The securities firms peddling mortgage-backed bonds did little to disabuse them of the notion that a CDO with a high rating must be as safe as houses—after all, the buyers were sophisticated institutions, not widows or orphans.

Moreover Wall Street has every reason to shovel securitised debt out as fast as it can. The loan-origination platform has high fixed costs, so it is a scale business. This can lead to trouble when there are not enough creditworthy new borrowers, as in subprime lending. Banks may be tempted to keep feeding the machine at the expense of laxer lending standards. “Once you get into it, it's a bit like heroin,” says Joseph Mason, an academic who has written on securitisation. When AAA paper is repeatedly compared to Class A drugs, you know something is wrong.

Rating the raters

Complexity and warped incentives foster the third cost of securitisation: gaming the regulations. Politicians are scrutinising the role of rating agencies, as they did with auditors after the dotcom bubble burst. Regulatory dependence on ratings has grown across the board. Banks can reduce the amount of capital they have to set aside if they hold highly rated paper, for instance, and some investors, such as money-market funds, must stick to AAA-rated securities. But not all top-rated paper is the same.

The agencies appear to have been too free in giving out prized AAA badges to structured products, especially CDOs. This was partly because their models were faulty, failing to pick up correlations between different markets, and partly because of a conflict of interest: theirs is one of few businesses where the appraiser is paid by the seller, not the buyer.

This made it easier for the banks securitising and further repackaging debt to create the greatest possible number of securities with the lowest regulatory cost (that is, highest rating). Investors restricted to investment-grade paper assumed (or at least hoped) that the rating was a guarantee of strength. It might have helped if the agencies had properly monitored their ratings after issuing them. But with low fees per security there is little incentive to stay on the case.

AFP

From dodgy American mortgages to the British high street

Avinash Persaud, of Intelligence Capital, a consultancy, argues that securitisation has let banks (as regulated “holders” of credit risk, with the capacity to keep it through bad times) pass it on to unregulated “traders” of risk with smaller balance sheets, such as hedge funds, which sell when trouble strikes. As a result, he says, although the risk of bank runs has fallen, the risk of market runs has increased.

In fact, some hedge funds are patient investors in illiquid assets. But Mr Persaud is right that risk changes, chameleon-like, depending on the holder. A bank with a plump capital cushion can use its balance sheet to hold on to out-of-favour credits until markets regain their balance. An investment fund that is several steps removed from the borrower, vulnerable to margin calls and constrained by daily risk models will have less room for manoeuvre. The rise of such investors has led, paradoxically, to more of a herd mentality because of “convergence in the way risk has been diversified”, says Mr Schwarcz.

Fans of securitisation argue that it has made the system safer, because risk ends up with those who want to shoulder it. It is true that few banks have failed in recent years, in spite of the Asian crisis, the failure of Long-Term Capital Management, the dotcom bust and so forth. But this could have more to do with economic stability than securitisation.

Indeed, André Cappon, a consultant, warns of the “circularity of risk”. The hedge funds that buy mortgage-linked debt also borrow heavily from the prime-brokerage arms of banks that originated many of the underlying loans. So a bank can push risk out of the front door, only to find it sneaking through the back.

Shine a light

What should banks and regulators do about all this? In the short run, the focus will be on transparency. Investors need to know who is holding what and how should it be valued. One idea is to force investment banks to reveal more about the performance and price of privately traded asset-backed instruments. Another is for the Securities and Exchange Commission, Wall Street's main regulator, to ensure consistent valuation of such assets across firms. More information on the vehicles that issue asset-backed commercial paper would also help.

There will also be calls for greater standardisation of structured products. This could undermine the “over the counter” (off-exchange) markets. Exchange groups like the Chicago Mercantile Exchange and Deutsche Börse have been trying to take business away from the banks, offering centrally cleared foreign-exchange trading and credit products. Regulators like these because they are more transparent than privately traded deals. The crisis could tip the balance in the exchanges' favour, says Benn Steil, a market-watcher at the Council on Foreign Relations.

If investors continue to shun the most complex products, Wall Street will have to offer simpler fare. Tom Zimmerman, head of asset-backed research at UBS, sees parallels between the CDO bust and the blow-up in collateralised mortgage obligations (CMOs) in the mid-1990s. CMOs, which pool prepayment risk, became so convoluted that investors could no longer see where the dangers lay. When they stopped buying, investment banks made the product more straightforward and it took off again.

As for the rating agencies, they have probably grown more powerful than anyone intended. Regulators will want to see their interests aligned more closely with investors, and to ensure that they are quicker and more thorough in reviewing past ratings. Moody's is thinking about adding new letter codes to cover liquidity and volatility risk for complex products.

Fixing the problem of fragmented responsibility will be a balancing act. Mr Sanders thinks subprime default rates would not have spiked if loan originators had been forced to set aside capital to cover, say, 10% of each securitised pool. But framing the terms of this sort of co-insurance would be tricky. Would 10% be enough? Or too much? Should a reputable bank have to pay as much as a small specialist-lender?

With investors, too, there is a risk of heavy-handedness. Calls for federal legislation on “assignee liability”, which would hold secondary-market investors liable for loan losses, could do more harm than good. The soul-searching has led some analysts to speculate that mortgage lending could, for a time, go back to being a bank-led lend-and-hold market.

But do not expect a rush back to the ways of the 1960s. Securitisation has become far too important for that. Indeed, it has not yet fulfilled its promise. Wall Street eggheads may be licking their wounds at present, but they will soon be coming up with even more products. And, given time, there will no doubt be another wave of buying. More importantly, the transformation of sticky debt into something more tradable, for all its imperfections, has forged hugely beneficial links between individual borrowers and vast capital markets that were previously out of reach. As it comes under scrutiny, the debate should be about how this system can be improved, not dismantled.

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* “The Promise and Perils of Credit Derivatives”, by David Skeel and Frank Partnoy, University of Cincinnati Law Review, 2006

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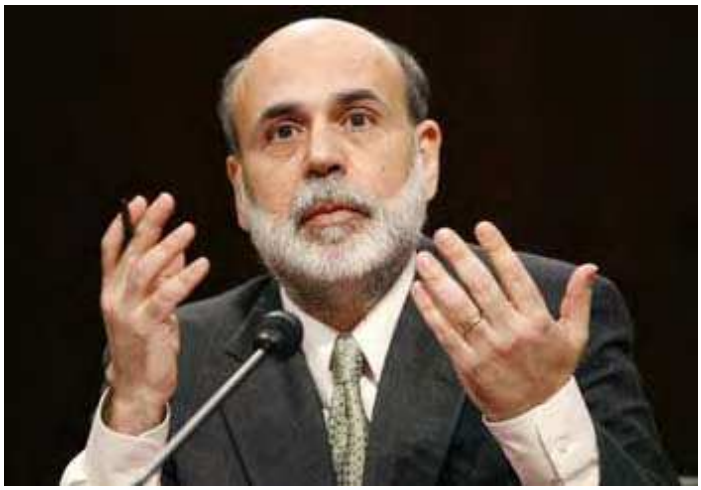
The Federal Reserve

Bernanke's bounty

Sep 20th 2007 | WASHINGTON, DC
From The Economist print edition

Reuters



Was the Federal Reserve's large cut in interest rates a sign of panic or prudence?

WALL STREET had been hoping for it. By some measures, financial markets had been half-expecting it. But when America's central bankers on September 18th cut the short-term federal-funds rate by half a percentage point, to 4.75%, investors reacted as gleefully as children who spy a chocolate birthday cake.

The Dow Jones Industrial Average ended the day up 336 points—a 2.51% gain, and the biggest one-day jump since April 2003. The broader S&P index rose 2.9%. Wall Street's giddier commentators could hardly contain themselves "I would hug these guys" gushed Jim Cramer, a CNBC pundit whose screaming pleas for lower interest rates epitomised August's panic.

The Fed's move came a day after Britain's government announced it would guarantee all deposits at the stricken mortgage lender, Northern Rock, and the day that Lehman Brothers reported third-quarter results that were not as bad as many had feared (see article).

A day later the Bank of England abandoned its hard-nosed attitude to greasing the money markets (see article). America's housing regulators also did an about-turn, announcing that they would allow the government-sponsored mortgage giants, Fannie Mae and Freddie Mac, to expand their portfolios to help alleviate the mortgage squeeze.

This barrage of good news worked a treat. Stock markets across the globe followed Wall Street upwards. Nerves calmed in the money markets and the most moribund corners of the credit landscape showed signs of life. Banks became more willing to lend to each other. Blue-chip borrowers raised billions of dollars of new debt. Even the junk-bond market began to function. R.H. Donnelley, the firm that publishes Yellow Pages, raised far more than the $650m it had planned in the first junk-bond issue of any size since late July.

To many on Wall Street, all this marked a turning point for which Mr Bernanke, in particular, deserves credit. Not only had the Fed recognised the risks that financial turbulence posed to America's economy, it had acted boldly to head them off. And that, concluded euphoric investors, would probably mean even lower interest rates ahead. Judging by the price of Fed funds' futures, financial markets reckon there is an 80% probability of another quarter-point cut on October 31st.

Not everyone was happy, however. Hawks worried that the Fed had bailed out Wall Street and compromised its inflation-fighting credentials. Far from eschewing the "Greenspan put" (Wall Street shorthand for the willingness of Alan Greenspan to cut interest rates in the face of financial turmoil), his

successor, Mr Bernanke, had created a put of his own. Allan Meltzer, author of a history of the Federal Reserve, called the decision a “big error”. The central bankers, he argued, had “listened to the Siren song” of the markets. History suggested they would regret it.

Several measures of inflationary jitters wobbled: the price of gold futures hit a 27-year high of $735.50 an ounce and yields on 30-year Treasury bonds rose. The dollar continued to slide, hitting a new low against the euro of close to 1.40. Mr Greenspan himself gave ammunition to the inflation worriers. His memoirs (see article) argued that the disinflationary pressures of the past were ebbing and central bankers' jobs were becoming harder.

Look carefully, however, and both Wall Street's euphoria and the hawks' nervousness are overdone. Inflation is always a risk, but the Fed is hardly in danger of allowing price pressures to get out of control. Figures released on September 19th showed that core consumer prices, excluding food and fuel, rose by 2.1% in the year to August, down from 2.2% in the year to July.

What is more, although the central bankers' actions were bold—in addition to cutting the federal funds rate, they also cut the discount rate by half a percentage point to 5.25%—monetary policy is hardly easy. One rule of thumb is to compare nominal interest rates to nominal GDP. At 4.75%, the Fed funds rate is now roughly in line with nominal GDP growth over the past few quarters, suggesting that interest rates are broadly neutral.

Perhaps most importantly, the central bankers left themselves plenty of room for manoeuvre. The statement accompanying the Fed's decision made clear that the rate cut was intended to “help forestall” the adverse effects on the economy from financial-market disruptions. But it made no commitment that more cuts would be coming. The central bankers said they would act “as needed to foster price stability and sustainable economic growth”. And this statement (unlike the previous one on August 17th) included an explicit reference to “inflation risks.”

Much depends on what drove the Fed's decision. Tactics may have played a role, particularly a desire to avoid a repeat of September 1998. After Russia's default and the collapse of Long-Term Capital Management, a hedge fund, the Fed cut rates by a quarter point. Disappointed, markets plunged and the central bankers were rattled into cutting rates again long before their next scheduled meeting. By acting boldly now, Mr Bernanke must hope to avoid hasty inter-meeting cuts.

Risk management undoubtedly played a part too. Even if the most likely outcome for the economy has not worsened dramatically, the risks of a truly nasty downturn have risen. A bold cut now was probably designed, in part, to reduce those risks.

New research from within the central bank doubtless bolstered the case too. Frederic Mishkin, a governor, argued forcefully in a recent speech that central bankers can cushion the impact of falling house prices on the economy, provided they act quickly and decisively, at little cost in terms of inflation. His simulations suggested that if central bankers behaved “optimally”, a 20% drop in house prices over two years would drag the economy's growth down no more than half a percentage point while consumer prices would rise less than 0.1 of a percentage point faster than they otherwise would.

Financial markets seem to share Mr Mishkin's confidence. This week's euphoria assumed policymakers would manage to stave off economic trouble. Investors all but ignored more bad news from the housing market—builders' pessimism at levels not seen since the 1991 recession and a further plunge in housing starts. But if, as seems likely, the economy shows more signs of weakness in coming weeks, confidence will wane. Then Mr Bernanke's party spirit will once again be tested.

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Money markets

A thaw in the cold war?

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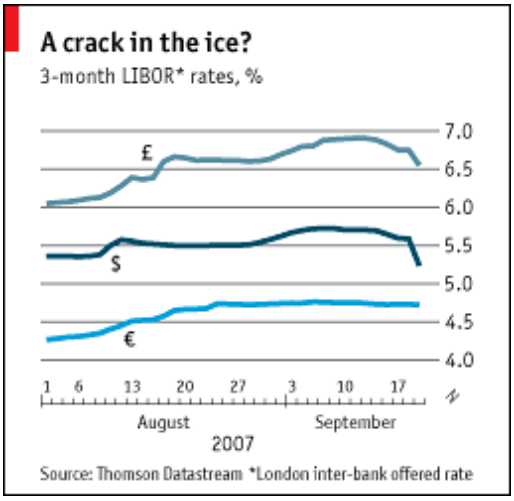
The best barometer of central bank success will be interbank rates



IT HAS been this summer's version of the cold war: a nerve-wracking stand-off between banks that are unwilling to lend to each other, which at times has looked as if it would seriously imperil parts of the banking industry. Even before the Federal Reserve's policymakers cut interest rates on September 18th there were signs of a thaw. But only if sentiment continues to improve, and the trickle of lending between financial firms becomes a torrent, can central bankers breathe easier.

That may explain why on September 19th, the Bank of England performed a startling U-turn, offering to lend £10 billion ($20 billion) to commercial banks in an emergency three-month auction. It also widened the collateral that it was prepared to accept to include mortgage loans. Less than a week before, its governor, Mervyn King, had said such moves risked stoking "moral hazard".

The auctions, the bank said, were meant to "alleviate the strains in longer maturity money markets". The Fed and the European Central Bank have both conducted similar operations which, analysts say, had begun to calm the interbank borrowing market. On September 19th the three-month London Interbank-Offered Rate (LIBOR) which banks use to lend to each other in dollars fell by 35 basis points to 5.24%. That offset some of the tightening that occurred as banks balked at lending to each other. LIBOR rates in sterling also improved, though in euros hardly at all (see chart above).

An additional sign that the money markets are moving again has come in the commercial-paper market, scene of many of this summer's banking shocks in countries as far afield as Germany, Canada and China. As confidence has returned, the volume of outstanding commercial paper in America—which shrank by an average of $75 billion a week for four weeks up to September 5th—has begun to stabilise.

Redemptions in asset-backed commercial paper (ABCP), which was the raciest part of the market and the most exposed to troubled American mortgages, have remained high. But investors are beginning to discriminate between good and bad assets—and, as Jenna Collins of Cairn Capital notes, good and bad asset managers.

Matt King, a credit analyst at Citigroup in London, says that ABCP investors continue to shy away from funding pools of loans known as collateralised-debt obligations. They are also avoiding investment vehicles that do not have guaranteed backstop facilities provided by banks. They are, however, prepared to fund better-quality asset-backed paper. Discrimination is half the battle in returning to more orderly markets.

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Investment banks

Books of revelation

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From The Economist print edition

Profits are down, disclosure is up

WAS this week's rate cut Ben Bernanke's coming-out bash, as one pundit suggested, or his caving-in bash? Certainly, it was good news for Wall Street. The shares of investment banks, pummelled by the mortgage mess and a drought in the buy-out market, posted their biggest daily gains in over a year.

But for those banks reporting third-quarter results, the week was less about elation than it was about revelation. After years of record profits but disappointing disclosure, the time had come to confess how they value, or "mark", loans and mortgage-backed securities. Uncertainty over these assets has been a big cause of market turbulence in recent months.

Lehman Brothers, the first to report, managed to hold up well despite sharply marking down some of its holdings: net profits were only 3% below last year's number, slightly above forecasts (though these had been cut in recent weeks). The write-downs cost the bank $700m. They would have been bigger were it not for large offsetting gains from hedging—though Lehman refused to be pushed on the nature of these face-saving activities.

Morgan Stanley, whose earnings were down by a more disappointing 17%, is biting the bullet too, writing down its leveraged-loan book by $940m. Similar moves were expected from Goldman Sachs and Bear Stearns when they reported, after *The Economist* went to press. "With expectations so low, now is a good time to show a bad hand," says Achim Schwetlick of the Boston Consulting Group.

Though the banks remain frustratingly opaque, they did at least go some way this week to placating those who suspect their accounting style of being more mark-to-make-believe than mark-to-market. Lehman, for instance, revealed that one-tenth of its trading assets are "level three" (the kind that is hardest to value), something that would usually only come out in later filings. It gave reams of information about its liquidity position, no doubt because it is strong. It admitted to having suffered "well above" $1 billion in paper losses on its portfolio of leveraged-buyout loans. Morgan Stanley admitted that its level-three assets had risen to 8% of the total, and that nearly 40% of its leveraged-loan commitments were "covenant-lite". Such confessions cannot be easy when the analysts asking the questions work for your rivals.

Will this be enough to persuade the doubters? The banks have done themselves no favours by offering inquisitive clients one set of criteria for valuing complex products while often using a different set in-house, admits a senior researcher at one. But they are probably doing their best to value them accurately, reckons Brad Hintz, an analyst with Sanford Bernstein (and a former chief financial officer of Lehman). The deliberate mismarking of assets is difficult to pull off on a large scale, he says, not least because accounting and risk-management systems sit on the same database. And with regulators poring over the banks, external auditors will be especially careful to sound the alarm if they spot discrepancies between different clients' valuation techniques.

But even if the banks are not deceptive, they may be mistaken. Most level-three assets are "marked to model", and the valuations are only as good as the assumptions that are plugged in. Investing in Wall Street remains an act of faith.

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Buttonwood

Mismatch of the day

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The new financial system has an age-old problem

THE financial system is built on a fundamental (and ever-present) mismatch. Savers want access to their money instantly, if necessary. But borrowers are usually unable to give it to them anything like as quickly.

The banks have traditionally bridged that gap. But the only way they can do so is to borrow short and lend long. This mismatch makes them vulnerable. That is why governments have imposed regulations on the banks, requiring them to hold reserves against an emergency. But if there is a complete loss of confidence among depositors, there is really not much an individual bank can do (see article). The central bank is usually obliged to help.

One of the reasons why the modern financial system was supposedly stronger than before was the reduced importance of the banks. Instead of hanging on to the loans they have made, they have parcelled them up and sold them on. The aim was to disperse risk; in the case of default, it was better for a lot of investors to lose a little than for a few banks to lose a lot.

In some cases, the repackaged loans have been bought by investors with long-term horizons, such as pension funds. But they do not have enough capital to replace the banks completely, nor do they have an appetite for the riskiest loans.

All the clever types of securitisation and structured products have not eliminated the fundamental mismatch. Someone still has to borrow short and lend long. Northern Rock, the stricken British bank, is a case in point. It is what used to be known as a secondary bank; borrowing the bulk of its money short-term from other banks (and the credit markets) rather than directly from the public to fund its energetic mortgage lending. When the money markets froze, it faced instant problems, since exacerbated by a loss of confidence among its depositors.

Hedge funds are another example. Many will have been attracted by the higher yields available on repackaged, or securitised, loans. But as the yields on such loans fell in recent years, the funds have needed to use more leverage (borrowed money) in order to generate returns that are sufficiently attractive to clients to justify their fees. As soon as yields started to rise (and the price of securitised loans started to fall), the hedge funds needed to cut their positions. The problem has been finding someone to sell to.

Mutual funds have had some exposure to securitised loans. But they have their own funding mismatch (investors can withdraw their money on a daily basis) and a limited desire to buy in a falling market. In the case of one class of mutual fund—the money-market funds—they are terrified of incurring losses that might cause them to “break the buck”, or repay their investors at less than par. So they have stopped buying.

Clearly, the new financial system is still vulnerable to the kind of credit crunch that has been seen through the ages. But instead of the problem starting with the banks, it has been precipitated by a “buyers' strike”.

Yet the banks still end up holding the bag. With investors no longer so prepared to take loans off the banks' hands, they are being forced to hang on to them, or offload them at a loss. In other cases, they are on the hook because they have financed the purchasers of the loans in the secondary market. They may be acting as prime brokers (and thus the main lenders) to hedge funds. Or they may have indulged in a little “regulatory arbitrage”, buying the loans through off-balance sheet vehicles, known as conduits, so they do not need to hold reserves against them. Those loans are coming back on to the balance sheet.

The lesson of all this is that those who believed risk had been eliminated from the system (or even substantially reduced) were being foolish. It has just emerged in different ways.

The remodelled financial system may turn out to have less frequent, but more severe, crises. It has made credit available to more people. To the extent those people then used their credit to buy assets, asset prices were forced higher, increasing the value of the collateral, and making the loans seem safer.

What the world has yet to see is a phase when this benign cycle goes dramatically into reverse. Over the past 20 years, central banks have always managed to stop the rot by cutting rates and restoring confidence.

Logic would suggest that this cannot continue forever, that there must be some point at which the debt burden is too high to be assuaged by lower interest rates. The coming weeks will show whether that point has finally arrived.

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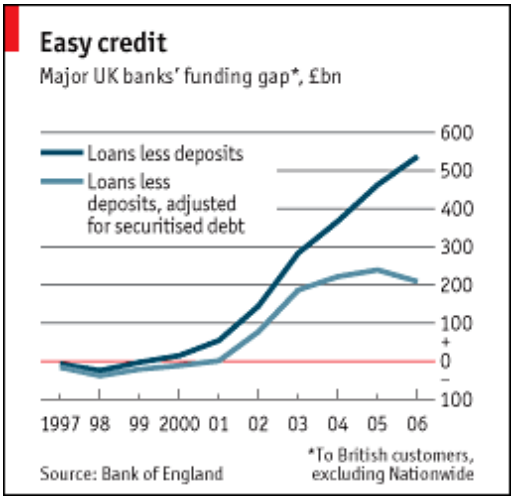
British banks

The great Northern run

Sep 20th 2007
From The Economist print edition

The Northern Rock saga points to troubles buried elsewhere in British banks

Get article background



GOOD old-fashioned bank runs are such rare events in rich countries that they have now become a spectacle. Among those who made a special trip this week to witness the undreamt-of sight of scores of middle-class people queuing to withdraw their savings from Northern Rock, Britain's fifth-largest mortgage bank, was Tim Price, a portfolio manager. “It was a very British bank run,” he says. “The queues were orderly, but the emotional impact will scar people for generations.”

Confidence lost is not easily regained, which raises the question of whether any more horrors lurk within Britain's banking system. Optimists assert that Northern Rock lived a bit faster and looser than the rest of the country's banks. Although all of them happily lent more money than they had gathered in retail deposits—as you would expect, especially given the buoyant housing market—none did so to the extent of Northern Rock. It relied on other banks and capital markets for three-quarters of its funding, compared with about half at its nearest competitors, Alliance & Leicester and Bradford & Bingley.

Northern Rock's reliance on capital markets explains why, despite the long queues outside its branches, this was not a typical bank run brought on only by a sudden collapse of confidence. Instead, it was a crisis that was long in the making, exploited by short-sellers and embarrassingly played down by some analysts (just last week a stockbroker advised clients to “load up on Northern Rock for your children, your mum and your goldfish”).

Talk of Northern Rock's exceptionalism is intended to soothe jangled nerves, since it suggests that other banks have pursued a less risky path. But there is a whiff of complacency there, too. Whether or not any other bank could possibly fail, the Northern Rock saga raises some disquieting questions about Britain's banking regulator, the Financial Services Authority (FSA). The regulator only belatedly drew attention to the weakness inherent in what it now calls Northern Rock's “extreme” funding model. The way oversight of the financial system is split between the FSA, the Treasury and the Bank of England is in doubt too. Gordon Brown's reform of a decade ago means that those responsible for monitoring the banking system are separate from those who make the decision to intervene. Pressure is mounting for this to be reformed.

There are also worrying vulnerabilities in the architecture of Britain's financial system. Chief among things keeping banks' risk officers awake at night is the wide disparity between loans and deposits in British banks. Professional worriers at the Bank of England's Financial Stability department reckoned in April that this “funding gap” stood at some £530 billion ($1 trillion) at the end of December—a figure that has almost certainly widened in the intervening nine months. Adjusted for loans that have been parcelled up into securities and then sold, the gap stood at little more than £200 billion (see chart above), much of which was financed by commercial paper and interbank loans.

In normal circumstances, this gap would matter little. Loans taken out by banks would come due and would simply be rolled over or repaid with the proceeds of fresh loans. But today, when banks are hoarding cash in case they need it and are unwilling to lend to each other for anything longer than a day at a time, loans lasting three months, for instance, are being replaced with overnight ones. As a result, many of Britain's banks are increasingly being pressed to approach the interbank market every day for ever-larger loans. A temporary glitch in the banking payment system or an unfounded rumour could leave an otherwise sound bank short of cash at the close of business, forcing it to ask the Bank of England to tide it over—which may imperil its future health.

If that were not bad enough, some now fret over the seemingly esoteric question of whether financial troubles, like buses, arrive in convoy. There is a growing worry, in Britain as elsewhere, that instead of spreading risk thinly around the financial system as they were meant to, innovations such as securitised loans and derivatives have in fact created a form of congestion.

The Bank of England warned of these dangers in April, pointing out that signs of vulnerability in one part of the financial system can quickly have knock-on effects in other parts. It sketched out a bleak scenario in which, for example, a rise in the price investors demand for holding risky assets in capital markets could make it harder and more expensive for companies and households to borrow. A slowing economy, falling house and office prices, a jump in loan defaults and a fall in income at investment banks could all follow. In extreme, banks could end up losing 30-40% of their core capital reserves, the bank said.

Is such an outcome likely? Willem Buiter, a former member of the bank's Monetary Policy Committee, reckons the logjam in money markets is already raising mortgage costs and choking off corporate lending. That would argue for a cut in official rates, not to mention the sort of liquidity provision the bank offered on September 19th. What is strange is that the bank, having identified the problem so early, took so long to do anything about it.

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Financial-sector rewards

Croesus's cousins

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What it all means for jobs and bonuses

“DEAR Valued Bloomberg User,” began an e-mail sent out recently by the information provider to the universe's masters. “This is [...] to remind you that we can still provide complimentary access to our service should you find yourself temporarily in-between jobs.” Having the bad news broken by another firm's computer could be a new low for an industry not known for letting people go tactfully (“Your pass stopped working today? I'm so sorry”). Happily things do not seem to be as bad as all that.

In London some jobs will probably go. The Centre for Economics and Business Research (CEBR) reckons that more than 5,000 people will be hauled in for a talk about career progression by the end of the year. For comparison, the City shed 20,000 jobs after the dotcom bubble burst and 40,000 after Black Wednesday in 1992. However, the CEBR reckons that 10,000 new jobs were created in the year to July, so any reduction would still mean a big net gain in jobs over a two-year period.

As for bonuses, one financial headhunter that specialises in finding drones rather than filling corner offices says that at least one City firm has told its managing directors (who are less senior than the title makes them sound) that a certain number of them will receive no bonus at all this year. This gloom is not widely shared: most report bonus expectations being managed rather than vaporised—provided, of course, that things get no worse.

In New York the picture is similar. Some areas that have been booming over the past year will be affected. M&A banking, where the pipeline of deals looks less than inspiring, leveraged loans and a few other corners of fixed income may do badly. Conversely, anyone who trades volatility, of which there has been plenty, or sells options, which should be a good business in uncertain times, will have prospered.

Even the people most at fault for the recent turmoil—the creators of the collateralised-debt obligations (CDOs) and conduits that spread subprime-mortgage debt around the financial system—may end the year with new Porsches. Headhunters on Wall Street report that some have been snapped up by hedge funds looking to extract some value from these illiquid instruments. Just as imprudent banks have been saved from their mistakes by indulgent central bankers, so CDO-makers could be rewarded for the mess that they helped to create. Vroom-vroom.

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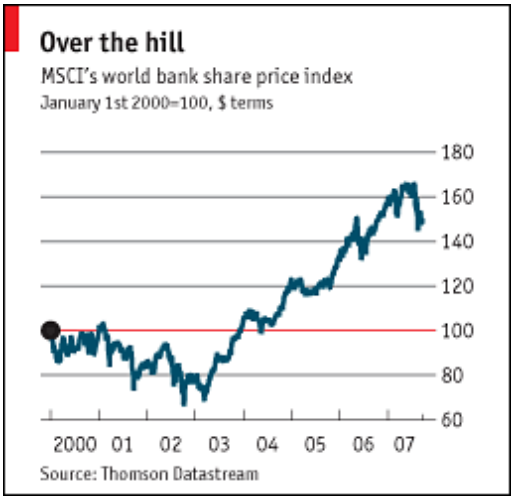
Banking

Brrrrrrrrr

Sep 20th 2007
From The Economist print edition

Banks face up to a new—and chillier—environment



A HUDDLE of emperor penguins, clustering together to ward off the Antarctic cold, swirls slowly, forcing birds in the middle of the group towards the frozen outer ranks. In the same way, continuing financial troubles have churned up the markets, exposing one set of financial institutions after another to icy scrutiny. Thanks to the difficulties faced by mortgage lenders in America and Britain, it is now the turn of institutions that rely heavily on the money markets for their funding to cower on the outside of the group. But everyone is feeling the chill.

Trouble among America's mortgage firms continued when Impac Mortgage Holdings added to the tally of job losses on September 18th, by announcing that it was stopping most of its lending activity. The investment banks are trying to reduce commitments to leveraged buy-out (LBO) funding—commitments that now look far too generous to borrowers. PHH, another American mortgage lender, revealed on September 17th that its planned $1.8 billion sale to General Electric, a conglomerate, and Blackstone, a private-equity firm, was in jeopardy because of funding difficulties. Bank of America, one of the world's largest banks, warned on the same day that the credit crunch would dent its earnings.

In the face of all this bad news, investors have been skittish. European bank shares were hard hit at the start of the week, with Irish and Spanish banks receiving some of the worst punishment. In Asia Japanese banking stocks also suffered, as concerns about the credit squeeze reinforced worries caused by unrelated news that Credia, a consumer lender, had filed for bankruptcy.

Shares rallied later in the week thanks to three palliatives: America's interest-rate cut, Britain's bail-out of Northern Rock and better-than-expected quarterly results from Lehman Brothers, an American investment bank. Still, the mood remains febrile. News of another big subprime loss could quickly spark fresh anxiety.

Re-evaluating the risky

Some worries are overblown. To date, the credit crunch has done a good job of weeding out victims. Subprime lending is an inherently risky business. The banks that have so far been bailed out after incurring heavy losses on subprime-related instruments were unusually exposed to liquidity risk. As risk has been repriced, the risk-takers have suffered most.

For the mass of banks, cushioned by years of good performance, solvency is not (yet) a worry. “The capacity of banks to absorb problems is very high,” says Ian Linnell of Fitch, a rating agency.

But if a widespread funding crisis is unlikely, fears of a sector-wide earnings crunch are much more plausible. The events of the summer will hurt banks in a number of ways. As well as the impact of direct losses from subprime securities and gummed-up LBO loans, banks will earn less money from complex structured products and private-equity deals. As loans come back on to balance sheets, institutions will need to store more capital against these assets.

Higher interbank financing costs will eat into margins and reduce lending growth. Some of this extra cost will be passed on to borrowers which will weaken demand for credit and exacerbate the risk of slowdowns in inflated housing markets.

Some institutions are better placed than others to deal with such problems. By reducing their reliance on jumpy wholesale markets, banks with a strong base of retail deposits have an advantage (such a base has potential bail-out benefits too: there is clearly nothing like a queue of worried pensioners to grab politicians' attention). Angelo Mozilo, boss of Countrywide, a troubled American mortgage lender, announced plans on September 18th to double its branch network in coming months.

Diversification is also helpful. Bouncier equity markets can help investment banks offset weaker performance in fixed-income products. Emerging markets have looked stable throughout the credit crunch and offer the prospect of relatively straightforward growth. “In a sense, emerging markets are the new defensive markets,” says Simon Samuels, an analyst at Citigroup.

As profits in their industry come under threat and bankers look to cut costs, dealmaking among banks may quicken. Banks with small retail networks and large mortgage books look vulnerable to acquisition. Investment could well rise in emerging markets. Some speculate that America's standalone investment banks, which are almost wholly reliant on the wholesale markets, may even seek the shelter of larger banking groups. Now is not the best time to launch ambitious takeovers but, when things are this frozen, huddling closer together makes sense.

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Europe's economy

At risk of infection

Sep 20th 2007 | BERLIN, PARIS AND ROME
From The Economist print edition

Will the euro zone's economy manage to decouple from America's?

“CLOUDS are gathering in the economic sky,” said Germany's economy minister, Michael Glos, to his fellow politicians in the Bundestag last week. Three developments prompted this warning: the rise in oil prices to beyond $80 a barrel, the strengthening of the euro to a record high against the dollar and the fear spread by the crisis in America's subprime mortgage market. If the outlook is darkening for Germany, Europe's biggest economy, others have even more to fret about.

Reuters

Towering problems may loom for Spain and Ireland

Economists are most nervous about who or what might sink into America's property swamp. Banks in the 13 countries that use the euro have roughly €360 billion ($500 billion) worth of exposure to off-balance-sheet “conduits” that invested in American subprime mortgages and similarly risky assets. That does not look like much compared with their €21 trillion of assets but, points out Dirk Schumacher of Goldman Sachs, no one knows which banks are most at risk or how much capital and liquidity these liabilities will eventually consume. Wary banks are demanding a high premium above the central bank's main interest rate to lend to each other for three months, if they do so at all. That may not change substantially until they disclose their positions in more detail.

America's property slump poses two additional risks. It could pull its economy into recession, which would dent global and European growth. A bigger danger is that Europe's property markets, a mainstay of growth in parts of Europe, will follow America's into the mire.

Property and credit woes threaten some economies more than others. In Spain investment in construction has risen by six percentage points as a share of GDP over the past ten years, to nearly 18%; Ireland has had a similar boom. The French economy has been kept afloat by consumer spending; business investment was the weak link, and firms are likely to be even more cautious after the market turbulence. In Italy companies “are heavily dependent on bank lending” because its bond market is underdeveloped, says Tito Boeri of the Bocconi University in Milan. A credit crunch would hurt.

In Germany, by contrast, companies finance themselves largely from their own buoyant profits and property prices have barely budged for years. Credit growth is close to zero, points out Joachim Scheide of the Institute for the World Economy in Kiel. But Germany will join the rest of Europe in fretting about oil and the euro. The currency's strength comes at a time when Germany's labour costs are beginning to creep up after a long decline, notes Michael Heise, chief economist of the Allianz financial group. It could also hurt Italian exporters, whose products compete directly with Asian consumer goods. Expensive oil could dampen next year's expected recovery in German consumer spending, which was dented this year by a hike in value-added tax rates.

Even without these depressants Europe's business cycle was probably past its prime. The central bank has doubled interest rates since December 2005, points out Jörg Krämer, chief economist of Commerzbank in Frankfurt. Growth wobbled in the second quarter of this year for various reasons (a spike in French imports and a drop in German construction, for example). Europe was not expected to match last year's growth of nearly 3% and is expected to slow further in 2008. Germany may continue to outperform France, which will be lucky to grow at more than 2% next year, unless economic reforms by Nicolas Sarkozy, the president, produce a surprise.

That level of growth is no disaster. Despite the second-quarter slowdown in the euro zone, employment jumped 1.7% from the year before. Joblessness is still high, but it has fallen quite sharply in the past two years. Measures of business confidence remain strong.

The European Central Bank will probably abandon a planned increase in interest rates this year—though its president, Jean-Claude Trichet, remains resolutely optimistic about the strength of the economy. Tax cuts should stimulate demand in Germany and France. Unless the American economy stumbles into recession, which looks less likely after the Fed's interest-rate cut, the clouds are more likely to bring a spot of rain rather than a storm to Europe's biggest economies.

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Economics focus

Confidence trick

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From The Economist print edition

Illustration by JAC

The problems involved in stopping a bank run

"MOST bankers dwell in marble halls/Which they get to dwell in because they encourage deposits and discourage withdrawals." Ogden Nash, the poet, captured the essence of banking, but how does one discourage withdrawals; in other words, avoid a run on the bank? As the turmoil at Northern Rock, a British bank, has shown, panic among depositors can lead to panic measures: in effect, the British government was rumbled into guaranteeing the deposits of any bank that suffers during this crisis.

The problem has dogged the financial system throughout history, for the simple reason that no bank can survive if enough of its depositors want to be repaid at the same time. Sometimes, subterfuge has been the only answer. In his classic study, "Manias, Panics and Crashes", Charles Kindleberger recounts how the Bank of England averted a run on its own finances in 1720. The bank managed to get its friends to the front of the queue and arranged for them to be paid, very slowly, in sixpences (then worth a fortieth of a pound). The friends then came back through another door to deposit the coins, which had to be laboriously counted again. This delayed the ability of other depositors to withdraw money until confidence was restored.

Another device is to close the bank altogether in the hope that depositors will change their minds in the meantime. Although a "bank holiday" in Britain is now seen as a chance to take the family to the seaside, it was once a device for calming markets. It seems unlikely, however, that steam-age delaying tactics would work in the era of 24-hour news coverage and internet banking.

An alternative is to organise a bail-out of the beleaguered bank, by urging other banks to chip in or buy it. In Britain many a small building society (a mutually owned mortgage bank) has been persuaded over the years to absorb one of its smaller competitors. As the rescues of IKB and SachsenLB showed last month, the German authorities can still pull this off.

Whether it is still possible in the Anglo-Saxon world is another matter. When the hedge fund Long-Term Capital Management wobbled in 1998, Bear Stearns, an American investment bank, refused to join in the rescue (hence the *Schadenfreude* at its recent travails). Global banks are less amenable to pressure from a single central bank. In addition, executives are answerable to shareholders who may question the merits of a rescue.

In the absence of a buyer, it is then up to the central bank to provide cash by acting as a "lender of last resort". The Federal Reserve was created, in part, because of the banking panic of 1907 and unease that the crisis was solved only through the intervention of a private financier, J. Pierpont Morgan. As J.K. Galbraith remarked, the early Fed did not exactly excel at its task: "In the twenty years before the founding [of the Fed], there were 1,748 bank suspensions, in the 20 years after it ended the anarchy of

unstable private banking, there were 15,502." Milton Friedman argued that the failure of the Fed to protect the banks from failure in the aftermath of the Wall Street crash of 1929 led to a shrinkage of the money supply and prompted the Great Depression. Central banks have since taken that lesson to heart.

The tricky part lies in distinguishing between the times when a bank has run into trouble because of poor management and those where there is a general panic. When it is the bank's fault, the purist would not rescue it at all, so as to teach investors a lesson. In an essay entitled "State Tampering with Money and Banks", Herbert Spencer, a British philosopher, said that "the ultimate result of shielding man from the effects of folly is to people the world with fools."

The Bank of England seemed to be heading down this path in early September, when its governor, Mervyn King, warned against "*ex post* insurance for risky behaviour". The problem, as Kindleberger explains, is that "history offers a number of occasions when the authorities were resolved not to intervene but found themselves reluctantly forced to do so." Northern Rock is just the latest example.

Unfortunately, depositors also find it difficult to tell between the problems of an individual bank and those of the system as a whole. Hence, in a version of Gresham's law, bad banks drive out good ones. When that happens, politicians cannot withstand the backlash from angry depositors and central bankers fear the economic effects of a credit crunch.

It thus becomes difficult for central banks to follow Walter Bagehot's famous advice in his book, "Lombard Street", about lending money only at a penalty rate against good collateral. Indeed, Bagehot himself said that, in a general crisis: "the only safe plan for the Bank is the brave plan, to lend in a panic on every kind of current security, or every sort on which money is ordinarily and usually lent. This policy may not save the Bank; but if it do not, nothing will save it."

Another consequence of the Depression was the creation of deposit insurance; by offering at least a partial guarantee for savers, the idea was to avoid the panic that led to a bank run in the first place. The fate of Northern Rock indicates that the British version does not do the job, because savers are unwilling to accept any loss and fear the bureaucratic delay in getting back their money. Hence the sudden guarantee for any struggling bank.

A big con, nonetheless

However, this offer is only as good as the credit of the guarantor. John Calverley notes in his book "Bubbles and How to Survive Them" that guarantees from the governments of Indonesia and Argentina over the past decade were simply not believed. A moment's reflection suggests that the British government could not really guarantee £1.3 trillion of consumer deposits either. But, just like the sixpences, the assurance has, for the moment, done the (confidence) trick.

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AIDS

Time to grow up

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The Guardian

“Abstinence only” education does not slow the spread of AIDS

THERE can be no surer way of averting a sexually transmitted infection such as AIDS than avoiding sex. That much is obvious. And it is also convenient for religious lobbyists who believe that premarital sex is a sin. But is it realistic? Those lobbyists argue that a popular alternative—known in the jargon as “abstinence-plus”—which recommends chastity but also explains how to use condoms, is likely to make things worse by encouraging earlier intercourse. “Abstinence-only” teaching, they reckon, should be more effective.

That, of course, is a possibility. But it is a testable possibility. And Kristen Underhill and her colleagues at the University of Oxford have, over the past few months, been testing it. Their conclusion is that it is wrong. Abstinence-only does not work. Abstinence-plus probably does.

Last month Dr Underhill published a review of 13 trials involving 16,000 young people in America. The trials compared the sexual behaviour of those given an abstinence-only education with that of those who were provided with no information at all or with whatever their schools normally taught. Pregnancies were as numerous in both groups. Sexually transmitted diseases were as widespread. The number of sexual partners was equally high and unprotected sex just as common.

Having thus discredited abstinence-only teaching, Dr Underhill and her colleagues decided to evaluate the slightly more complicated message of “abstinence-plus” using 39 trials that involved 38,000-odd young people from the United States, Canada and the Bahamas. Their results are published in the current issue of *Public Library of Science Medicine*.

This tuition—compared, as before, with whatever biology classes and playgrounds provide—reduced the number of pregnancies in three out of seven trials (the remaining four recorded no difference). Four out of 13 trials found that abstinence-plus-educated teenagers had fewer sexual partners, while the remainder showed no change. Fourteen studies reported that it increased condom use; 12 others reported no difference. Furthermore, in the vast majority of cases, abstinence-plus participants knew more about AIDS and HIV (the virus that causes the disease) than their peers did. And the tuition often reduced the frequency of anal sex (which brings a greater chance of passing on HIV than the vaginal option). In contrast to the fears of the protagonists of abstinence-only education, not one of the trials found that teenagers behaved in a riskier fashion in either the long or the short term after receiving abstinence-plus instruction.

Unfortunately (and surprisingly) only two of the studies addressed the question of disease transmission directly, and the numbers involved were too small to find a statistically significant difference between groups. Nevertheless, Dr Underhill's pair of reviews should make informative reading for policymakers. America's government earmarks money for abstinence-only teaching, which is matched by individual states. It should review that policy—which is clearly no better than the alternatives, and is probably worse. Its generosity to needy foreigners is similarly prescriptive. Of the $15 billion promised over five years by PEPFAR, President George Bush's personal anti-AIDS initiative, $1 billion is reserved for groups that intend to fight AIDS without mentioning condoms. Though Dr Underhill's results apply only to North America, they do suggest a need to investigate what happens elsewhere, in case PEPFAR's policy, too, needs to be reviewed.

A dose of prevention

Teaching people about what they might wear during intercourse is an important way of reducing the chance of them catching HIV. But teaching them, in addition, about what drugs they could take to reduce that risk may be added to the syllabus in the future. A vaccine is still a long way off, but four clinical trials—in Peru and Ecuador, Thailand, Botswana and also America—are assessing how well daily anti-retroviral pills, which are normally prescribed to control established HIV infections, prevent the virus infecting healthy people who do dangerous things. The results of these trials will be plugged into epidemiological computer models to assess the likely effect of various drug-distribution policies.

One model intended to do exactly that has already been built, by Ume Abbas and John Mellors of the University of Pittsburgh. It is designed to mimic a mature HIV epidemic in sub-Saharan Africa—which it did rather well when the researchers tested its output against data from Zambia, a country in which the epidemic has remained stable for a decade.

Writing in *PLoS Medicine*'s sister journal, *PLoS ONE*, Dr Abbas and Dr Mellors describe what happened when they added prophylactic anti-retroviral drugs to the model. They experimented with different measures of drug efficacy and with different groups of people taking the pills.

Assuming that anti-retrovirals work 90% of the time and are taken by three-quarters of sexually active people, their model suggests that new HIV infections in sub-Saharan Africa would be cut by 74% over 10 years. Unfortunately, the idea of providing and delivering so many drugs to so many people is logistically implausible. And even if it could be done, it would cost about $6,000 per HIV infection averted—a lot of money in Africa.

However, giving the drug to the 16% of Africans who behave most riskily would be easier and could lead to a 29% reduction over a decade at only a tenth of that cost. A harsh calculation, but a realistic one—unlike expecting teenagers to give up sex because you tell them to.

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The search for Steve Fossett

Turk and rescue

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The high-tech hunt for a missing adventurer

AP

Never give up

AS *The Economist* went to press, Steve Fossett, a famed and fearless aviator who went missing over the Nevada desert on September 3rd, had not been found. But it was not for want of trying. Mr Fossett has been the subject of one of the most intensive civilian manhunts in history—and also, fittingly, one of the most technological. Besides the usual panoply of search-and-rescue aircraft deployed by America's Civil Air Patrol, which wound down its search on September 17th, a different sort of search effort is being conducted online, using satellite photographs.

These pictures of the search area are being provided by two firms that supply information to Google Earth: GeoEye and DigitalGlobe. The search itself is being co-ordinated by a corner of the Amazon empire called Mechanical Turk. This is an online job market which farms out tasks that humans are good at, but for which software is poorly equipped, like labelling images and transcribing speech. For the Fossett hunt, volunteers comb through the images and flag any that include what might be a plane or its wreckage.

Among those who keep track of slightly less high-profile missing-person cases, the story will be strikingly familiar. In January Jim Gray, one of Microsoft's programming gurus, disappeared while sailing near San Francisco Bay. Mr Gray was as big a celebrity among computer geeks as Mr Fossett is among thrill-seekers, and the story played out in the same way. A friend at Amazon, Werner Vogels, got in touch with DigitalGlobe, and the firm provided thousands of images. Within four days, Mechanical Turk was hosting the images and more than 10,000 volunteers were sifting through them—though to no avail, as Mr Gray was never found.

Mechanical Turk's director, Peter Cohen, says that now the search protocol has been established, conducting such “distributed” searches is much easier. The limiting factor is the satellite imagery—which obviously has to be up-to-date. At the moment, only three commercial satellites provide the kind of resolution that can help in efforts like the Fossett hunt. The firms that own them have governments as their main customers. This makes search-and-rescue imaging a secondary concern.

That looks set to change, though. DigitalGlobe launched its second satellite, *WorldView-1*, on September 18th, and will launch a third late next year. GeoEye will launch its second next spring. This machine should set a new record for commercial satellite resolution: just 41cm (though that will still not be quite good enough to spot people as well as planes). In total, these launches will double the amount of satellite time that can be dedicated to requests for instant pictures.

Cost, however, is less of a problem. Areas such as the Nevada desert and San Francisco Bay are not strategic, so taking photographs of them does not displace paying customers—indeed, DigitalGlobe is not charging for the pictures being used in the Fossett hunt. With the extra capacity provided by the new satellites, the cost will drop even further. And Mr Cohen is convinced that the internet will always come up with the few thousand volunteers needed to scour the resulting images. Far from being the invasion of privacy it was recently claimed to be, the technology behind Google Earth may in time grow to be a standard search-and-rescue tool.

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Alternative energy

Sea green

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Using the sea to grow biofuel

ONE of the crazier ideas for dealing with global warming is to sprinkle the oceans with iron filings. One reason the sea (unlike the land) is not covered with plants is that it lacks crucial nutrients—iron, in particular. Add iron, the theory goes, and you will promote the growth of algae. These will absorb carbon dioxide from the atmosphere and then conveniently sink when they die. Thus, over the course of a few decades, the concentration of the gas in the atmosphere will return to pre-industrial levels. Presto! Problem solved.

The law of unintended consequences argues against doing any such thing, of course. But an experiment carried out a decade ago in the Southern Ocean suggests that the underlying idea is sound—and at a conference in Oxford this week, John Munford, an independent British researcher, suggested that a more modest version of the “fertilise the oceans” project might indeed help to stop climate change.

Mr Munford's proposal is to harvest the algae, rather than allowing them to die and sink. He notes that many species of algae pack a far denser punch energy-wise than the plants now used as energy crops. In particular, they produce oils of the sort valued as biodiesel, and are attracting a lot of attention from scientists and entrepreneurs looking for fuels to replace mineral oils.

The existing projects, though, are looking at freshwater algae. These have to be nurtured in ponds that require attention and occupy land that could be used for other things. The sea, by contrast, is both free and self-maintaining.

Mr Munford reckons an area the size of the North Sea could yield enough biodiesel to replace the fossil fuels used in transport today. How you harvest the algae, most of which would be a millimetre or less across, is less clear. But if that could be done economically, biofuel aquaculture would be about as green as you could get.

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Taxonomy

Name, rank and serial number

Sep 20th 2007
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Biologists want to barcode half a million species in the next five years

THE tale of the unknown goby began in 1982 when Benjamin Victor, of the Ocean Science Foundation in Irvine, California, discovered an unusual fish in a reef in Panama. With only a single specimen he was hard pressed to prove it was a new species, so the fish remained, unnamed, on his desk for 25 years. Then, last year, he was sent an unusual fish larva. Using a new kind of DNA identification called barcoding he showed that it was a younger version of his mystery goby and that both specimens were, indeed, a new species.

DNA barcoding was invented by Paul Hebert of the University of Guelph, in Ontario, Canada, in 2003. His idea was to generate a unique identification tag for each species based on a short stretch of DNA. Separating species would then be a simple task of sequencing this tiny bit of DNA. Dr Hebert proposed part of a gene called cytochrome c oxidase I (COI) as suitable to the task. All animals have it. It seems to vary enough, but not too much, to act as a reliable marker. And it is easily extracted, because it is one of a handful of genes found outside the cell nucleus, in structures called mitochondria.

The idea worked, and it has dramatically reduced the time (to less than an hour) and expense (to less than $2) of using DNA to identify species. And thus, in July this year, Dr Victor's mystery goby became *Coryphopterus kuna.* It was the first vertebrate to have its DNA barcode—a sequence of about 600 genetic "letters"—included in its official description.

Barcoding has taken off rapidly since Dr Hebert invented it. When the idea was proposed, it was expected to be a boon to taxonomists trying to name the world's millions of species. It has, however, proved to have a far wider range of uses than the merely academic—most promisingly in the realm of public health.

One health-related project is the Mosquito Barcoding Initiative being run by Yvonne-Marie Linton of the Natural History Museum in London. This aims to barcode 80% of the world's mosquitoes within the next two years, to help control mosquito-borne diseases. Mosquitoes are responsible for half a billion malarial infections and 1m deaths every year. They also transmit devastating diseases such as yellow fever, West Nile fever and dengue. However, efforts to control them are consistently undermined by the difficulty and expense of identifying mosquitoes—of which there are at least 3,500 species, many of them hard to tell apart.

So far Dr Linton's team has used the COI gene to distinguish 390 species of mosquito, of which 7% have turned out to be new species. *Anopheles oswaldoi*, for example, was known to be a carrier of malaria in northern, but not southern, Brazil. That was puzzling. DNA barcoding, however, has shown that *A. oswaldoi* is actually four species, of which only one carries malaria. That explains the geographical discrepancy and should also assist efforts to curb the disease in Brazil by allowing the real culprit to be studied in detail.

Fly titles

The mosquito initiative has also had a piece of luck. Using some chemical wizardry, Dr Linton has been able to get barcodes from old, dried museum specimens collected as long ago as 1916. Between the Natural History Museum and the Smithsonian Institution in Washington, DC, 70% of the world's mosquito species are pinned and ready to be barcoded.

In a bid to track down the remainder quickly, Dr Linton plans, next month, to join a floating research institute—the *Scholar Ship*—that will be docked in Panama. There, she will offer a drop-in mosquito-identification service. All she asks in exchange for identifying mosquitoes is a copy of their barcodes. And Panama is only the first port of call. The ship will go on to sail around the world, offering a rapid-sequencing service wherever it docks; in half an hour, Dr Linton's machine can generate almost 100

barcodes.

Herbal medicines may also benefit. John Kress and David Erickson, who both work at the Smithsonian, have barcoded all 689 species listed in *World Economic Plants*. They intend to screen the content and quality of natural plant products used as medicines. In doing so, they have had to identify a new kind of barcode, as the COI gene is not found in plants.

Another group that could benefit from barcoding are customs officers, says Mark Blaxter, an evolutionary biologist at the University of Edinburgh. For those struggling to prevent the importation of pests or endangered wildlife, rapid and accurate identification tools are essential—particularly when perishable goods are being held up. America's Department of Agriculture is creating barcodes for the world's fruit flies. These are important agricultural pests and often arrive in the country as hard-to-identify larvae, or eggs, on fruit. Another group at the National Chung Hsing University in Taiwan (where hundreds of newly minted experts in the field have just met for the Second International Barcode of Life Conference) have created a prototype barcoding biochip. This is a collection of miniature DNA test sites on a sliver of glass that will rapidly discriminate between four species of fruit flies.

Barcoding's ease of use is also attracting interest from other government agencies. America's Federal Aviation Administration and its air force are working on bird barcoding. They want to scrape bits of tissue from planes, discover which birds are most often being struck, and thus work out which bird-migration routes to avoid. Another researcher, Mark Siddall, of the American Museum of Natural History in New York, has used barcoding to show that purported examples of *Hirudo medicinalis* (the medicinal leech approved by America's Food and Drug Administration as a prescription medical device for stopping blood clots) are sometimes another leech entirely.

Dr Hebert hopes to have half a million barcodes available online within the next five years. Both his laboratory at Guelph and the Smithsonian's Laboratories of Analytical Biology can sequence the COI gene rapidly, and have thus been dubbed “barcode factories”, so this looks feasible.

In the long term, barcoding enthusiasts envisage something called a “barcoder”. It will be a hand-held device that reads barcodes on the spot. The days will soon be over when a strange little fish waits a quarter of a century for a new name.

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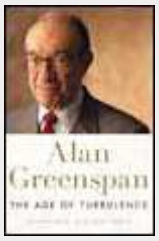
Alan Greenspan's memoirs

The Undertaker's story

Sep 20th 2007
From The Economist print edition

Not many surprises in this memoir-cum-essay except that it is an unexpectedly enjoyable read

The Age of Turbulence: Adventures in a New World
By Alan Greenspan



Penguin Press; 531 pages; $35 and £25

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AP

AS CHAIRMAN of the Federal Reserve for the better part of two decades, Alan Greenspan was the world's most influential economic policymaker. Down the years he was skilful or lucky, or both, since the American economy fared well under his stewardship. But nobody ever accused Mr Greenspan of being a lively speaker, let alone a born storyteller, and no reviewer could approach this volume with anything but a heavy heart and a sense of duty.

“The Age of Turbulence” is a dull title, tending to confirm one's fears, and that risible subtitle, “Adventures in a New World”, is fooling nobody. Yet, despite everything, the book turns out to be first-rate. It engages on different levels: it is intelligent in a way that few popular books on economics manage or even try to be; and, wonder of wonders, it is a good read. No doubt, Mr Greenspan had help with the writing: he acknowledges Peter Petre, a talented co-writer, as a collaborator. For this one can only be grateful. Who would have guessed that 500 pages in Mr Greenspan's company could slip by so easily?

Good or bad, the book for which Penguin reportedly advanced $8m is news. Nearly two years after his

retirement, reporters' zeal for misdivining Mr Greenspan's meaning is (as he would once have put it) not markedly impaired. Once the *Wall Street Journal* had cunningly evaded strict pre-launch security by buying a copy in a bookshop, the race was on to find shocking disclosures.

Two were seized upon. First, the book criticises George Bush for letting public spending rip. It would have been shocking if Mr Greenspan, a libertarian Republican, had said anything else. As for the other, the *Washington Post* got the scoop: it declared one of its crack team of readers to be the first to reach page 463, where Mr Greenspan says that the Iraq war was “largely about oil”—a remark that subsequently “proved controversial”, the newspaper noted. But the words were taken out of context. Mr Greenspan was not talking about an intended oil grab, but only meant to say that Iraq matters as much as it does because of where it is. This was not especially shocking either.

There is nothing sensational in “The Age of Turbulence”. It is better than that. It combines two different narratives in a surprisingly adept way. The book's first half is a memoir; the rest is essays on the main economic issues confronting governments over the next few decades. Mr Greenspan's take on the future is informed by his earlier experience and rooted in his intellectual development. Both parts work fine; the best thing is that they sit so well together.

Mr Greenspan turns out to be a more interesting character than you might have guessed. He started out as a professional saxophone player, albeit one with a passion for corporate accounting. While the rest of the band sloped off to get stoned, he did his business-studies homework and wrote up their tax returns. For a time he trained with Stan Getz, a renowned saxophonist, and writes of recognising at once an inborn talent that he could never match, no matter how hard he worked.

Later he joined the circle surrounding Ayn Rand, a libertarian novelist-philosopher. In an early encounter, she baffled him into affirming the possibility that he did not exist. She called him the Undertaker because of his gloomy demeanour, and was to be heard for a time asking of her new follower: “Well, has the Undertaker decided whether he exists yet?”

Mr Greenspan relates America's economic history since the 1950s through his experience in business and in government, and then at the Fed. For those familiar with the record, little is new, but those who are not would struggle to find a better account. The facts and anecdotes are handled deftly, without preening.

The pace slows in the book's forward-looking second half. The tour of issues—China's prospects, Russia's prospects, Latin America's prospects, demographics, corporate governance, inequality, energy and so on—sometimes threatens to become a trudge. But Mr Greenspan knows plenty, has limitless curiosity about economic facts and figures and reflects deeply on it all. He is a good guide.

Economists are divided on Mr Greenspan's legacy. Many have nothing but praise, but some argue (and this newspaper has tended to agree with them) that he had a habit of keeping interest rates too low for too long, tolerating and even encouraging bubbles in the stockmarket and the housing market.

On this view, the maestro is deeply implicated in the financial markets' current difficulties. He mentions these charges and says why he did as he did, but not in much detail. He never seems prickly or defensive. He admits to many mistakes: in supporting the administration's tax cuts without adequately emphasising the need for spending restraint; and in advocating the recklessly (as it turned out) expanded use of adjustable-rate mortgages. But he is unrepentant and none too informative on whether central banks should act pre-emptively against asset-price inflations.

To go into that issue thoroughly would have made the book more technical than Mr Greenspan presumably wished it to be. He owed the publisher a popular book and he apparently feels no need to vindicate himself. If “The Age of Turbulence” has a gap, this is it—but the readers for whom the book is intended are unlikely to mind. They are likely, in fact, to be delighted. Sales are running at a torrid pace. Whether they are fast enough to catch up with an $8m advance is another matter.

The Age of Turbulence: Adventures in a New World
By Alan Greenspan.
Penguin Press; 531 pages; $35 and £25

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The Weimar Republic

The best and the worst

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From The Economist print edition

NEARLY a century has passed but the Janus face of the Weimar Republic appals and attracts as much as ever. On the one side, hyperinflation, mass unemployment and political assassination; on the other, dazzling creativity in the arts and sciences—not to mention myriad forms of nightlife to suit every taste, however odd. It was indeed, as Dickens said of the French revolution, the best of times and the worst of times, the spring of hope and the winter of despair.

Weimar Germany: Promise and Tragedy
By Eric D. Weitz

Princeton University Press; 448 pages; $29.95 and £17.95

Buy it at
Amazon.com
Amazon.co.uk

Did Germany's convulsive experiment with democracy between 1919 and 1933 ever stand a real chance? One might well think not. Born in chaos after the slaughter of a war lost through what many Germans wrongly construed as a "stab in the back", the fledgling republic was hamstrung from the start. It concocted a "perfect" constitution that gave as much scope to its foes as to its friends, and it was saddled by vengeful victors with reparations demands that were all but impossible to meet. Towards the end of the republic's life, one-third of the labour force was jobless. When Hitler's matchless ability to tap resentment and hatred is added to this poisonous mix, Weimar's plunge into dictatorship looks to have been inevitable.

Or was it? The real wonder is not that Weimar failed but that it lasted as long as it did—longer, after all, than the 12 years of Hitler's "1,000-year Reich". For a while, from 1924 when the currency was stabilised (or rather re-invented) and the economy recovered, it even seemed to be succeeding against all the odds. In the 1928 general election, extremists of left and right were trounced and the Nazis in particular were close to despair—until, that is, the Wall Street crash and subsequent depression gave them a new, finally decisive boost. Through all these peaks and troughs, writers and artists and composers and the rest, as though rightly aware time was not on their side, flung out one formidable modern classic after another.

The literature on Weimar is immense, but we could well do with a single, authoritative, jargon-free volume that pulls all the strands together. Eric Weitz, a professor at the University of Minnesota, has made a valiant stab at producing one, but he does not quite succeed. He is a reliable guide through Weimar's political and economic maze, and a good one on the social revolution that made many women (far from all) less dependent on husband, hearth and home. In one of his best chapters, Mr Weitz takes us on a ramble through the sleepless metropolis of 1920s Berlin: from the glittering cafés around Potsdamer Platz to Isherwood's cabarets and seedy bars, from the bracing beaches of Wannsee Lake to the dank and stifling dwellings of the workers' quarter, Wedding.

The author's touch is less sure when he turns to literature and music. Naturally Mr Weitz had to be selective: but does it, for instance, make sense to devote six pages alone to Thomas Mann's "Der Zauberberg" and next to nothing to the bitterly satirical work of Thomas's elder brother Heinrich, who better saw where Weimar was stumbling? No quarrels with the choice of the Brecht/Weill "Die Dreigroschenoper" as a Weimar work *par excellence*; but there is next to nothing on Schönberg (who spent 1925-33 in Berlin) nor on Berg or Krenek, nor on the Kroll Opera House, which under Klemperer and Zemlinsky presented Weimar's—perhaps the world's—most daring repertoire and stagings. Nor will fans of the peerless Berlin Philharmonic easily forgive Mr Weitz for identifying their orchestra as the (more lowly) Berlin Symphony.

More seriously, Mr Weitz's account badly lacks a context. We learn much about the (astonishing) development of social security under Weimar, about seething anti-Semitism and diplomatic blunders. What we lack is a scene-setting chapter explaining the background to all these things. Nor is enough sketched about life in other great European cities to explain what made Weimar unique. Were women less liberated in London, were artists less bold in Paris? Why was the political left bitterly split in Germany but not in Austria, which had lost not just a war but an empire?

Whatever the flaws, this remains an often gripping (and splendidly illustrated) work from which two main lessons can be drawn. One is how quickly democracy can slip away. In 1928 the Nazis won just 2.6% of the vote; five years later Hitler was in power. The other, which Mr Weitz rams home in his last pages, is how often democracy is under most threat not from enemies abroad but from those who use its institutions and claim to speak in its name. These lessons are hardly new. But they are well worth stressing at a time when, in the name of the fight against international terrorism, individual liberties in democratic societies are being steadily curtailed.

Weimar Germany: Promise and Tragedy
By Eric D. Weitz
Princeton University Press; 448 pages; $29.95 and £17.95

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British nature

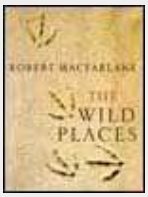
Visions in ditches

Sep 20th 2007
From The Economist print edition

LIKE a medieval holy man, or modern hippie, Robert Macfarlane sets out for the remote parts of the northern and western British isles, sea-sprayed islands, craggy mountains and great bog plains. He wants to experience wildness. There is not an icy pool he will not plunge into or tree he would not climb. He picks up shards of roughened granite and smooth flints and turns them in his hand. He says: “We have in many ways forgotten what the world feels like.”

A Cambridge academic, who has previously written about men's fascination with mountains, Mr Macfarlane does not forsake civilisation. On the two occasions that the elements threaten him—on the summit of Scotland's northernmost mountain and at the foot of a remote Hebridean climb—he briskly retreats. In scholarly fashion, his urge is to map, to classify and to name. He presents his travels as a “story map” (medieval forebear of the Ordnance Survey grid map) connected by incident and historical anecdote. As a narrative ruse, it is a little too cute. As, indeed, is Mr Macfarlane's beautifully worked but sometimes monotonous prose. Nonetheless, this is indeed a good book, replete with wonderful tales.

The Wild Places
By Robert Macfarlane



Granta Books; 340 pages; £18.99

Buy it at
Amazon.com
Amazon.co.uk

Like that of Schiehallion: a Scottish mountain so resembling an isosceles triangle that an 18th-century mapmaker used its measurements to estimate the density of the Earth. Or of W.H. Murray, a chronicler of Scotland's hills, who kept his sanity in a Nazi prison-camp by describing them on toilet paper. Or, perhaps the strangest, a metaphoric connection that Mr Macfarlane makes between the holloways of Dorset—lanes deep-trodden into its yellow sandstone—and the 16th-century recusant Catholics who skulked in the county.

Predictably, Mr Macfarlane comes to realise that every place in Britain's crowded archipelago is swamped in human history. Its empty margins have been cleansed of large populations: western Ireland by 19th-century famine and emigration; northern Scotland by 19th-century emigration and evictions. He adjusts his idea of wildness. It is not nature unsullied, but nature itself: “the sheer force of ongoing organic existence, vigorous and chaotic.”

Like many English poets, he comes to find “visions in ditches”. A lichen-encrusted hawthorn trunk appears as a “shaggy centaur's leg”. But British nature is everywhere depleted. Of 6,000 acres (2,400 hectares) of surface limestone pavement, 200 remain undefaced. Since the second world war, a quarter of a million miles (about 400,000km) of hedgerows have been erased; another 2,000 miles disappear each year.

As the climate warms, more terrible change is threatened. Scottish sea-bird colonies are already starving, as their prey heads north for colder waters. Every year, almost an acre of Essex salt-marsh, a precious flood-defence, is lost to the rising seas. England's last great beech woods, Mr Macfarlane worries, may wither in his lifetime: 50-year-old trees are showing signs of a decline typically found in trees three times as old.

There may be no hope of arresting this change. Yet Mr Macfarlane consoles himself with the thought that nature, endlessly changing, will not all die. The beech woods, too, will move north. And when people are gone, nature will remain. “The wild prefaced us, and it will outlive us.” It is a depressing hope. But, amen.

The Wild Places
By Robert Macfarlane.
Granta Books; 340 pages; £18.99

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American interest groups

Land of the small

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From The Economist print edition

IT IS common knowledge that Latino influence in the United States is big and growing. Less well known is that a significant sub-group—some 10m people—of the country's Latino population is not Catholic but Protestant. Less known still is the influence those Protestant Hispanics had on the 2004 presidential election: the sharp increase in their support for George Bush after 2000 (while the voting pattern of Catholic Hispanics remained unchanged) was a key force in his re-election.

Meet a microtrend, one of a multitude of fast-growing, below-the-radar forces that, Mark Penn argues, are changing America. The land of the big (and home of the megatrend) turns out in important and often unexpected ways to be the land of the small. Microtrends can move markets as well as turn elections.

Mr Penn has for years been taking his trend-spotter's magnifying glass to opinion polls and other data in search of small but intense signals that can give a decisive advantage to those who detect them. Politicians from Bill Clinton to Tony Blair have sought his advice; he is currently the main strategist for Hillary Clinton's presidential bid. As chief executive of Burson-Marsteller, a public-relations firm, he advises some of the world's biggest companies. Once a phenomenon or interest group amounts to 1% of the population—a critical threshold for microtrends—the Pennometer starts twitching.

It twitches, for example, at the discovery that more than 3m Americans are now “extreme commuters”, travelling more than 90 minutes to work every day and forming a ready market for in-car entertainment as well as a voting block that will react particularly strongly against any increase in fuel taxes. In all, Mr Penn and his co-author Kinney Zalesne have collected 75 microtrends, covering a range of topics from technology and teens to food and fashion. A few of these trends are perhaps too “micro” to be worth including. But most are intriguing and many are surprising. Astonishingly, 1% of young Californians say they expect to become “snipers”.

Observing Americans' propensity to come together in numerous interest groups is as old as Alexis de Tocqueville. But two things are new, and may account for a multiplication of microtrends. First, the internet is making it far easier for people with niche interests to find fellow enthusiasts. Second, there seems to be a greater tolerance for unorthodox individual choices, reflected in trends as diverse as a rise in left-handedness and a sea-change in attitudes to mixed-race marriage.

What broader picture emerges from Mr Penn's pointillist observations? As more and more small groups define themselves more sharply than ever, America is no longer a melting pot. It is becoming a nation of niches. Indeed, some will see a cause for concern in the apparent trend towards increasing fragmentation.

One worrier is Cass Sunstein, a law professor at the University of Chicago. In “Republic.com 2.0” he points to the danger of niches becoming “echo chambers” in which only the views of like-minded people are heard, thanks to the internet making it easy for people to filter information into a personalised selection, “the Daily Me”. A healthy democracy, he argues, depends on exposure to diverse or unexpected opinions. If Americans wall themselves off from topics and opinions they prefer to avoid, narrowing their horizons, their democracy will suffer.

Microtrends: The Small Forces Behind Tomorrow's Big Changes
By Mark Penn and E. Kinney Zalesne

Twelve Books; 425 pages; $25.99. Allen Lane; £20

Buy it at
Amazon.com
Amazon.co.uk

Republic.com 2.0
By Cass R. Sunstein

Princeton University Press; 251 pages; $24.95 and £14.95

Buy it at
Amazon.com
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But niches do not need to imply narrow-mindedness. On the contrary, as Mr Sunstein accepts, the internet holds far more promise than risk. Mr Penn, for his part, remains an optimist. He sees in microtrends a triumph of tolerance and individual choice. Certainly the implications are in many cases anything but small. All the usual assumptions about the coming crisis in America's Social Security (pensions) system will have to be rethought if the trend towards working beyond the normal retirement age gathers pace. And Mr Penn's skill in picking pertinent microtrends could help decide whether or not his candidate becomes America's first female president.

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The use of words

Life is a foreign language

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From The Economist print edition

EARLIER this year Steven Pinker appeared on “The Colbert Report”, an American television programme. Mr Pinker, a professor of psychology at Harvard with a full head of energetically curly hair, is famous for being super-clever in a relaxed, media-friendly, funky-boffin kind of way. Both the hair and the cleverness featured to great effect on this occasion. After teasing Mr Pinker about his explosive locks, the programme's host mockingly challenged him to explain, in five words, how the human mind works. “Brain cells fire in patterns,” Mr Pinker shot back. The live audience roared their approval.

No doubt there will also be roars of approval for Mr Pinker's new book, “The Stuff of Thought”. His previous bestsellers—“The Language Instinct” and “The Blank Slate” among them—have gained him two Pulitzer prize nominations and millions of devoted fans. Like those earlier books, this one sets out to address the big questions about what makes us tick.

In each of his nine chapters Mr Pinker looks at a different aspect of how we put our thoughts and feelings into words. He addresses a dismayingly wide variety of subjects, from the heavy-duty (how language is learned, the use of metaphor and the ways in which prepositions and verbs relate to our conceptions of time and space) to the feather-light (fashions in children's names, the conventions of romantic comedy and the seemingly irresistible human impulse to swear).

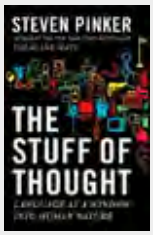
Mr Pinker's admirers will be familiar with his views on these matters since he has written about them all before. Perhaps that accounts for the book's bitty, cobbled-together feel. “The Stuff of Thought” reads not as a sustained development of a single line of argument but as a hotchpotch of loosely related ideas. Individually, its chapters are interesting; those that touch or expand on his central belief in a Darwinian theory of language acquisition are especially so. The book is shot through with fine thoughts and keen perceptions but, in the end, does not convince. Part of the problem is that Mr Pinker's thesis—that language is a window into human nature—is so broad as to admit practically anything with a linguistic bent to it as evidence.

And for a writer admired for his clarity of thought and elegance of expression, there is an awful lot of clotted verbiage. “Though space, time and causality (together with logic and substance) organise our world,” he writes at one point, “the paradoxes that infect these concepts—space and time being neither finite nor infinite, choices being neither caused nor uncaused—prove they are not part of the self-consistent world but part of our not-necessarily-consistent minds.” That is not nonsense. But the way he has put it is enough to give anyone brain-ache. It certainly takes the pop out of pop-science.

Fortunately, Mr Pinker is incapable of being dull for very long. Plus he is able to wheel on a formidable array of expert witnesses, both living and dead, to speak wisely and wittily in support of his views and generally jolly things along. Plato, Kant, Twain, Shakespeare and Yogi Berra crop up repeatedly. So does Woody Allen, whose winning line “I told him to be fruitful and multiply, but not in those words” beautifully distils Mr Pinker's point that, when something unpleasant happens to us, our conversation “turns abruptly to sexuality, excretion or religion”.

The Stuff of Thought: Language as aWindow into Human Nature
By Steven Pinker.
Viking; 499 pages; $29.95 and £25

The Stuff of Thought: Language as a Window into Human Nature
By Steven Pinker



Viking; 499 pages; $29.95 and £25

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Henry Moore's outdoor sculptures

Bronze glory amid the trees

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Kew Gardens provides a leafy background for Moore's large works

Kew Gardens

“I WOULD rather have a piece of my sculpture put in a landscape, almost any landscape, than in, or on, the most beautiful building I know,” wrote Henry Moore. Yet much of his work has ended up in cities, and outdoor exhibitions are rare. So the planting of 28 monumental sculptures in London's Kew Gardens is a notable event. Until March 30th 2008, visitors to the Royal Botanic Gardens can touch, walk round and peer through (polite notices discourage climbing over) the massive bronzes—and one white fibreglass—created by Moore in the last 30 years of his life. After that, 18 of the sculptures will be shipped across the Atlantic to be shown in New York Botanical Garden from May to November 2008 and in Atlanta Botanical Garden from May 2009 to January 2010.

The logistics of installing an outdoor Moore exhibition are daunting. Nearly all the exhibits came from the Henry Moore Foundation, based at Moore's old home at Perry Green in Hertfordshire, which is curating the show. But most of them are vast and some make unusual demands. “Double Oval”, for instance, seems to rest lightly, directly on the grass, but in fact calls for a steel frame below the ground to support its mass of glowing bronze.

Would Moore, who died in 1986, consider a garden an ideal setting for his great organic beasts? His preference was for the wild and natural, not for formality or ornamental flowerbeds. But Kew is the reverse of prim. Its vast acres of sloping greenery, its glades and its trees present a striking backcloth. The trees, some so ancient and so bent that they are sculptures themselves, enhance the majesty and the subtlety of the bronzes. As the visitor strolls round, sometimes into, Moore's abstract forms, their asymmetrical holes and crevices allow ever-changing glimpses of the garden's natural beauty. As the seasons change and the trees grow gradually skeletal, the view through the gaps will dramatically alter.

Rather than working from sketches, Moore would mould or carve tiny plaster models or maquettes; as he grew old, his assistants would take on the heavy work of enlargement. Some of these maquettes, together with the cheesegraters and files he used to texture the rich-brown or weathered-green patina of the finished sculptures, are on show in the Nash Conservatory at Kew. So is an array of the natural objects that informed his work: flintstones, shells, tangled roots, gnarled bits of driftwood, bones. He was particularly drawn to bones: one of the most moving pieces at Kew, “Oval with Points”, is said to have been inspired by an elephant's skull. As he gazed at the skull of an elephant, Moore once wrote, he began to see “great deserts and rocky landscapes, big caves on the sides of hills, great pieces of architecture, columns and dungeons.”

Moore was fascinated by the interaction of exterior and interior forms, the armour that protects the body,

the shell that protects the snail. An outstanding example of stern exterior guarding intricate interior is the magnificent “Large Upright” that stands sentry between Kew's Palm House and Pagoda. Protection at its most tender is shown in the “Draped Reclining Mother and Baby” reproduced here. This is a work that brings together some of Moore's major themes—internal/external forms, reclining figure, mother and child—and does so with extraordinary grace.

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Alex the African Grey

Sep 20th 2007
From The Economist print edition

Science's best known parrot died on September 6th, aged 31

Brandeis University

THE last time Irene Pepperberg saw Alex she said goodnight as usual. “You be good,” said Alex. “I love you.” “I love you, too.” “You'll be in tomorrow?” “Yes, I'll be in tomorrow.” But Alex (his name supposedly an acronym of Avian Learning Experiment) died in his cage that night, bringing to an end a life spent learning complex tasks that, it had been originally thought, only primates could master.

In science as in most fields of endeavour, it is important to have the right tool for the job. Early studies of linguistic ability in apes concluded it was virtually non-existent. But researchers had made the elementary error of trying to teach their anthropoid subjects to speak. Chimpanzee vocal cords are simply not up to this—and it was not until someone had the idea of teaching chimps sign language that any progress was made.

Even then, the researchers remained human-centric. Their assumption was that chimps might be able to understand and use human sign language because they are humanity's nearest living relatives. It took a brilliant insight to turn this human-centricity on its head and look at the capabilities of a species only distantly related to humanity, but which can, nevertheless, speak the words people speak: a parrot.

The insight in question came to Dr Pepperberg, then a 28-year-old theoretical chemist, in 1977. To follow it up, she bought a one-year-old African Grey parrot at random from a pet shop. Thus began one of the best-known double acts in the field of animal-behaviour science.

Dr Pepperberg and Alex last shared a common ancestor more than 300m years ago. But Alex, unlike any chimpanzee (with whom Dr Pepperberg's most recent common ancestor lived a mere 4m years ago), learned to speak words easily. The question was, was Alex merely parroting Dr Pepperberg? Or would that pejorative term have to be redefined? Do parrots actually understand what they are saying?

Bird brained

Dr Pepperberg's reason for suspecting that they might—and thus her second reason for picking a parrot—was that in the mid-1970s evolutionary explanations for behaviour were coming back into vogue. A British researcher called Nicholas Humphrey had proposed that intelligence evolves in response to the social environment rather than the natural one. The more complex the society an animal lives in, the more wits it needs to prosper.

The reason why primates are intelligent, according to Dr Humphrey, is that they generally live in groups. And, just as group living promotes intelligence, so intelligence allows larger groups to function, providing a spur for the evolution of yet more intelligence. If Dr Humphrey is right, only social animals can be intelligent—and so far he has been borne out.

Flocks of, say, starlings or herds of wildebeest do not count as real societies. They are just protective agglomerations in which individuals do not have complex social relations with each other. But parrots such as Alex live in societies in the wild, in the way that monkeys and apes do, and thus Dr Pepperberg reasoned, Alex might have evolved advanced cognitive abilities. Also like primates, parrots live long enough to make the time-consuming process of learning worthwhile. Combined with his ability to speak (or at least “vocalise”) words, Alex looked a promising experimental subject.

And so it proved. Using a training technique now employed on children with learning difficulties, in which two adults handle and discuss an object, sometimes making deliberate mistakes, Dr Pepperberg and her collaborators at the University of Arizona began teaching Alex how to describe things, how to make his desires known and even how to ask questions.

By the end, said Dr Pepperberg, Alex had the intelligence of a five-year-old child and had not reached his full potential. He had a vocabulary of 150 words. He knew the names of 50 objects and could, in addition, describe their colours, shapes and the materials they were made from. He could answer questions about objects' properties, even when he had not seen that particular combination of properties before. He could ask for things—and would reject a proffered item and ask again if it was not what he wanted. He understood, and could discuss, the concepts of “bigger”, “smaller”, “same” and “different”. And he could count up to six, including the number zero (and was grappling with the concept of “seven” when he died). He even knew when and how to apologise if he annoyed Dr Pepperberg or her collaborators.

And the fact that there were a lot of collaborators, even strangers, involved in the project was crucial. Researchers in this area live in perpetual fear of the “Clever Hans” effect. This is named after a horse that seemed to count, but was actually reacting to unconscious cues from his trainer. Alex would talk to and perform for anyone, not just Dr Pepperberg.

There are still a few researchers who think Alex's skills were the result of rote learning rather than abstract thought. Alex, though, convinced most in the field that birds as well as mammals can evolve complex and sophisticated cognition, and communicate the results to others. A shame, then, that he is now, in the words of Monty Python, an ex-parrot.

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Overview

Sep 20th 2007
From The Economist print edition

The **Federal Reserve** cut its benchmark interest rate by half a percentage point, to 4.75%. The reduction came amid a further weakening in America's housing market. The National Association of Home Builders index of expected sales fell to a 16-year low. Housing starts fell 2.6% in August to their lowest level since June 1995.

Consumer prices in **America** fell by 0.1% in August, leaving them 2.0% higher than a year earlier. The core measure, which excludes food and energy, rose by 2.1% in the year to August, the lowest rate in 17 months.

China's central bank raised its one-year lending and deposit rates by 0.27 percentage points, to 7.29% and 3.87% respectively. The move followed the biggest rise in consumer prices in more than a decade.

The **Bank of Japan's** policy board voted to keep its benchmark interest rate unchanged at 0.5% on September 19th.

Consumer prices in **Britain** rose by 1.8% in the year to August, down from 1.9% in July and the lowest rate in over a year. There was a downward effect on inflation from falls in the cost of financial services, following new guidelines for home mortgage charges by Britain's financial regulator.

The **euro area's** trade surplus rose to €4.6 billion in July from €1.1 billion a year earlier.

Switzerland's central bank raised its three-month interest-rate target by a quarter of a percentage point, to 2.75%.

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Asian growth forecasts

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From The Economist print edition

Asia is a bright spot in an otherwise darkening outlook for the world economy. The 43 developing countries in the region are expected to grow by 8.3% in 2007 and 8.2% in 2008, says the Asian Development Bank in an update of its 2007 Outlook. The bank has revised up the forecasts it made in March, largely based on the stronger performance of China and India. Although developing Asia is expected to slow only marginally in 2008, there are risks to that forecast. A recession in America that affected Japan and the euro area would hit growth in Asia too. But large foreign-exchange reserves and more robust financial systems mean that the region is better equipped to weather a downturn.

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Output, prices and jobs

Sep 20th 2007
From The Economist print edition

Output, prices and jobs

% change on year ago

	Gross domestic product				Industrial production	Consumer prices			Unemployment
	latest	qtr*	2007†	2008†	latest	latest	year ago	2007†	rate‡, %
United States	+1.9 Q2	+4.0	+2.0	+2.6	+1.7 Aug	+2.0 Aug	+3.8	+2.7	4.6 Aug
Japan	+1.6 Q2	−1.2	+2.4	+2.2	+3.2 Jul	nil Jul	+0.3	nil	3.6 Jul
China	+11.9 Q2	na	+10.5	+9.6	+17.5 Aug	+6.5 Aug	+1.3	+3.0	9.5 2006
Britain	+3.0 Q2	+3.3	+2.9	+2.4	+0.9 Jul	+1.8 Aug**	+2.5	+2.4	5.4 Jul††
Canada	+2.5 Q2	+3.6	+2.5	+2.7	+0.3 Jun	+1.7 Aug	+2.1	+2.4	6.0 Aug
Euro area	+2.5 Q2	+1.2	+2.7	+2.3	+3.7 Jul	+1.8 Aug	+2.3	+2.0	6.9 Jul
Austria	+3.8 Q2	+4.0	+2.9	+2.6	+6.0 Jun	+1.7 Aug	+1.8	+1.8	4.3 Aug
Belgium	+2.9 Q2	+2.4	+2.6	+2.3	+3.3 Jul	+1.1 Aug	+1.6	+1.8	11.9 Aug‡‡
France	+1.3 Q2	+1.3	+2.0	+2.2	+2.6 Jul	+1.2 Aug	+1.9	+1.5	8.0 Jul
Germany	+2.5 Q2	+1.0	+2.8	+2.3	+4.4 Jul	+1.9 Aug	+1.7	+2.0	9.0 Aug
Greece	+4.2 Q2	na	+3.7	+3.2	+3.5 Jul	+2.5 Aug	+3.5	+2.6	8.2 Jun
Italy	+1.8 Q2	+0.5	+2.0	+1.7	−0.2 Jul	+1.6 Aug	+2.2	+1.9	6.2 Q1
Netherlands	+2.4 Q2	+0.6	+2.7	+2.6	+4.1 Jul	+1.1 Aug	+1.7	+1.8	4.5 Aug††
Spain	+4.0 Q2	+3.2	+3.7	+2.8	+4.0 Jul	+2.2 Aug	+3.7	+2.7	8.0 Jul
Czech Republic	+6.0 Q2	+5.7	+5.2	+4.0	+6.9 Jun	+2.4 Aug	+3.1	+2.6	6.4 Aug
Denmark	+0.6 Q2	−1.6	+2.1	+2.0	nil Jul	+1.1 Aug	+2.0	+1.8	3.3 Jul
Hungary	+1.4 Q2	+0.8	+2.7	+3.0	+9.4 Jul	+8.3 Aug	+3.5	+7.5	7.0 Jul††
Norway	+3.9 Q2	+3.5	+2.7	+2.5	+2.9 Jul	+0.4 Aug	+1.9	+0.8	2.5 Jun††
Poland	+6.7 Q2	na	+6.3	+5.1	+9.0 Aug	+1.5 Aug	+1.6	+2.3	12.0 Aug‡‡
Russia	+7.8 Q2	na	+6.7	+6.2	+3.8 Aug	+8.7 Aug	+9.7	+7.8	5.9 Jul‡‡
Sweden	+3.5 Q2	+3.7	+3.5	+3.2	+5.2 Jul	+1.8 Aug	+1.6	+1.8	4.8 Aug‡‡
Switzerland	+2.8 Q2	+3.0	+2.4	+2.1	+7.3 Q1	+0.4 Aug	+1.5	+0.7	2.6 Aug‡‡
Turkey	+3.9 Q2	na	+6.0	+5.2	+3.9 Jul	+7.4 Aug	+10.3	+9.0	8.9 Q2‡‡
Australia	+4.3 Q2	+3.8	+3.8	+3.4	+5.5 Q1	+2.1 Q2	+4.0	+2.4	4.3 Aug
Hong Kong	+6.9 Q2	+8.2	+6.2	+5.2	−1.5 Q1	+1.6 Aug	+2.5	+1.9	4.2 Aug††
India	+9.3 Q2	na	+8.4	+7.9	+7.1 Jul	+6.5 Jul	+6.7	+5.8	7.6 2006
Indonesia	+6.3 Q2	na	+6.3	+6.2	+3.6 Jun	+6.5 Aug	+14.9	+5.8	9.8 Feb
Malaysia	+5.7 Q2	na	+5.9	+5.7	+2.1 Jul	+1.9 Aug	+3.3	+2.1	3.4 Q1
Pakistan	+6.6 2006§§	na	+6.4	+5.8	+6.0 Jun	+6.5 Aug	+8.9	+6.5	6.2 2006††
Singapore	+8.6 Q2	+14.0	+6.2	+4.4	+21.6 Jul	+2.6 Jul	+1.1	+0.9	2.4 Q2
South Korea	+4.9 Q2	+7.0	+4.7	+5.1	+14.3 Jul	+2.0 Aug	+2.7	+2.4	3.2 Aug
Taiwan	+5.1 Q2	na	+4.4	+4.6	+13.0 Jul	+1.6 Aug	−0.6	+0.9	3.9 Jul
Thailand	+4.4 Q2	+5.2	+4.2	+4.8	+7.2 Jul	+1.1 Aug	+3.8	+2.3	1.6 Jun
Argentina	+8.7 Q2	+8.8	+7.3	+5.5	+2.3 Jul	+8.7 Aug	+10.7	+9.1	8.5 Q2‡‡
Brazil	+5.4 Q2	+3.2	+4.6	+4.3	+6.8 Jul	+4.2 Aug	+3.8	+3.5	9.5 Jul‡‡
Chile	+6.1 Q2	+6.5	+5.9	+5.3	+4.0 Jul	+4.7 Aug	+3.8	+3.3	7.0 Jul†††‡‡
Colombia	+8.1 Q1	+10.3	+6.4	+5.1	+12.4 Jul	+5.2 Aug	+4.7	+5.7	11.1 Jun‡‡
Mexico	+2.8 Q2	+5.3	+3.1	+3.4	+2.4 Jul	+4.0 Aug	+3.5	+3.9	4.0 Jul‡‡
Venezuela	+8.9 Q2	na	+5.6	+3.9	+11.2 Jun	+15.9 Aug	+14.9	+18.7	8.4 Q2‡‡
Egypt	+7.4 Q1	na	+7.0	+7.2	+10.5 2006	+8.5 Aug	+8.9	+8.4	9.0 Q1‡‡
Israel	+4.4 Q2	+6.1	+5.1	+4.5	+1.3 Jun	+1.0 Aug	+2.2	+0.3	7.6 Q2
Saudi Arabia	+4.3 2006§	na	+4.0	+5.7	na	+3.8 Jul	+2.2	+3.0	na
South Africa	+5.0 Q2	+4.5	+4.8	+5.2	+3.1 Jul	+7.0 Jul	+5.0	+5.8	25.5 Sep‡‡
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*								
Estonia	+7.3 Q2	na	+7.9	+5.8	+4.4 Jul	+5.7 Aug	+5.0	+6.0	5.1 Jun
Finland	+4.7 Q2	+3.8	+3.9	+2.7	+0.5 Jul	+2.3 Aug	+1.9	+1.4	6.9 Aug
Iceland	+2.5 Q2	+9.1	+1.2	+1.6	+7.6 2006	+3.4 Aug	+8.6	+4.8	0.9 Jul‡‡
Ireland	+7.5 Q1	+20.1	+4.8	+3.4	+13.9 Jul	+4.8 Aug	+4.4	+4.7	4.7 Aug
Latvia	+11.3 Q2	na	+9.6	+7.5	+1.8 Jul	+10.1 Aug	+6.8	+8.3	5.7 Jun
Lithuania	+8.0 Q2	+8.2	+7.8	+6.9	na	+4.6 Aug	+4.2	+4.6	2.8 Jul
Luxembourg	+6.2 Q1	+6.6	+5.2	+4.2	+4.0 Jun	+1.9 Aug	+2.8	+2.2	4.1 Jul‡‡
New Zealand	+2.7 Q1	+2.5	+2.8	+3.1	nil Q1	+2.0 Q2	+4.0	+2.4	3.6 Q2
Peru	+8.4 Jul	na	+7.1	+5.5	+12.1 Jul	+2.2 Aug	+1.9	+1.2	7.6 Jun‡‡
Philippines	+7.5 Q2	+7.1	+6.0	+5.6	−4.7 Jun	+2.4 Aug	+6.3	+2.9	7.4 Q2‡‡
Portugal	+1.6 Q2	+1.7	+1.8	+2.1	+1.0 Jul	+2.1 Aug	+2.9	+2.4	7.9 Q2‡‡
Slovakia	+9.4 Q2	na	+8.0	+6.0	+18.9 Jul	+2.3 Aug	+5.1	+2.7	8.2 Aug
Slovenia	+5.9 Q2	na	+5.6	+4.6	+8.9 Jul	+3.5 Aug	+3.2	+3.0	7.5 Jun‡‡

*% change on previous quarter, annual rate. †*The Economist* poll. ‡National definitions. §Economist Intelligence Unit estimate/forecast. **RPI inflation rate 3.8% in Jul. ††Latest three months. ‡‡Not seasonally adjusted. §§Year ending June.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; Centre for Monitoring Indian Economy; OECD; ECB

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The Economist commodity-price index

Sep 20th 2007
From The Economist print edition

The Economist commodity-price index

2000=100

	Sep 11th	Sep 18th*	% change on one month	% change on one year
Dollar index				
All items	205.0	207.2	+6.2	+21.5
Food	188.8	190.0	+9.5	+40.0
Industrials				
All	226.0	229.5	+2.9	+6.4
Nfa†	158.8	162.1	+2.4	+16.2
Metals	262.7	266.4	+3.1	+3.6
Sterling index				
All items	153.2	157.4	+5.5	+14.8
Euro index				
All items	137.0	138.2	+3.3	+11.3
Gold				
$ per oz	706.00	715.25	+8.7	+23.5
West Texas Intermediate				
$ per barrel	78.23	82.07	+18.1	+33.1

*Provisional †Non-food agriculturals.

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Trade, exchange rates, budget balances and interest rates

Sep 20th 2007
From The Economist print edition

Trade, exchange rates, budget balances and interest rates

	Trade balance* latest 12 months, $bn	Current-account balance latest 12 months, $bn	Current-account balance % of GDP 2007†‡	Currency units, per $ Sep 19th	Currency units, per $ year ago	Budget balance % of GDP 2007‡	Interest rates, % 3-month latest	Interest rates, % 10-year gov't bonds, latest
United States	−818.7 Jul	−793.2 Q2	−5.7	–	–	−1.3	4.95	4.52
Japan	+93.2 Jul	+192.6 Jul	+4.4	116	117	−2.5	0.73	1.58
China	+244.9 Aug	+249.9 2006	+10.7	7.51	7.93	−0.7	3.53	4.43
Britain	−158.6 Jul	−93.0 Q1	−3.3	0.50	0.53	−2.7	6.53	4.98
Canada	+47.9 Jul	+21.9 Q2	+1.6	1.02	1.13	0.6	4.01	4.37
Euro area	+29.2 Jul	+3.6 Jun	nil	0.72	0.79	−0.6	4.73	4.28
Austria	+1.1 Jun	+13.2 Q1	+2.9	0.72	0.79	−0.5	4.72	4.40
Belgium	+17.6 Jul	+12.5 Mar	+2.2	0.72	0.79	−0.1	4.79	4.45
France	−40.1 Jul	+15.8 Jul	−1.2	0.72	0.79	−2.5	4.72	4.37
Germany	+228.1 Jul	+192.3 Jul	+5.1	0.72	0.79	0.4	4.72	4.28
Greece	−47.8 Jun	−36.7 Jul	−8.6	0.72	0.79	−2.4	4.73	4.58
Italy	−18.7 Jun	−50.3 Jun	−2.3	0.72	0.79	−2.6	4.72	4.55
Netherlands	+49.0 Jul	+53.5 Q2	+7.9	0.72	0.79	0.6	4.72	4.38
Spain	−121.0 Jun	−122.3 Jun	−8.8	0.72	0.79	2.1	4.72	4.41
Czech Republic	+3.1 Jul	−4.5 Jul	−3.5	19.8	22.4	−4.1	3.47	4.55
Denmark	+4.8 Jul	+4.7 Jul	+2.1	5.34	5.87	3.8	4.90	4.39
Hungary	−1.9 Jul	−6.2 Q1	−5.2	180	215	−6.0	7.61	6.65
Norway	+53.3 Aug	+54.6 Q2	+14.9	5.58	6.52	16.8	5.49	4.82
Poland	−8.1 Jun	−12.6 Jul	−3.0	2.70	3.11	−2.3	5.10	5.61
Russia	+125.1 Jul	+77.7 Q2	+6.8	25.2	26.8	3.0	10.00	6.56
Sweden	+19.4 Jul	+29.7 Q2	+6.8	6.62	7.27	2.4	3.51	4.26
Switzerland	+11.1 Aug	+102.1 Q1	+16.1	1.19	1.25	0.3	2.78	2.86
Turkey	−55.6 Jul	−33.2 Jul	−7.3	1.23	1.47	−2.8	18.35	6.91§
Australia	−11.7 Jul	−47.1 Q2	−5.4	1.17	1.33	1.3	6.85	5.98
Hong Kong	−20.0 Jul	+23.8 Q1	+10.9	7.79	7.79	1.8	4.52	4.08
India	−67.9 Jul	−9.6 Q1	−1.4	40.2	46.0	−3.3	7.08	8.24
Indonesia	+42.2 Jul	+10.3 Q1	+2.2	9,225	9,168	−1.6	8.15	6.51§
Malaysia	+28.8 Jul	+25.9 Q1	+14.3	3.46	3.68	−3.1	3.62	5.04§
Pakistan	−13.6 Aug	−6.8 Q1	−4.1	60.6	60.6	−4.6	9.74	8.34§
Singapore	+38.1 Aug	+41.6 Q2	+24.0	1.51	1.59	0.3	2.69	2.72
South Korea	+20.0 Aug	+6.9 Jul	+0.3	927	951	0.5	5.34	5.42
Taiwan	+14.3 Aug	+28.3 Q2	+5.8	33.1	32.9	−1.9	2.70	2.55
Thailand	+9.5 Jul	+11.5 Jul	+3.5	34.3	37.8	−1.9	3.55	4.15
Argentina	+10.7 Jul	+7.8 Q1	+3.4	3.13	3.10	1.3	14.31	na
Brazil	+44.1 Aug	+11.5 Jul	+0.7	1.86	2.16	−2.3	11.18	6.16§
Chile	+24.4 Aug	+8.3 Q2	+3.6	513	538	8.0	5.76	5.02§
Colombia	−1.5 Jun	−4.1 Q1	−3.0	2,056	2,399	−0.2	8.90	6.00§
Mexico	−0.8 Jul	−7.0 Q2	−1.0	11.0	10.9	0.1	7.22	7.72
Venezuela	+23.8 Q2	+20.4 Q2	+9.3	2,147	2,729	−3.1	11.07	6.55§
Egypt	−14.1 Q1	+3.1 Q1	+2.3	5.62	5.74	−5.5	7.20	5.23§
Israel	−9.0 Aug	+7.8 Q2	+3.5	4.07	4.33	−1.1	4.30	5.26
Saudi Arabia	+146.6 2006	+98.9 2006	+24.0	3.75	3.75	19.2	5.11	na
South Africa	−9.2 Jul	−17.4 Q2	−6.2	7.06	7.39	0.5	10.10	8.45
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Estonia	−4.1 Jun	−3.0 Jun	−16.3	11.2	12.3	3.2	5.20	na
Finland	+12.5 Jul	+12.3 Jul	+6.2	0.72	0.79	4.2	4.62	4.37
Iceland	−1.8 Aug	−3.7 Q2	−16.7	63.2	70.1	3.7	14.13	na
Ireland	+36.0 Jun	−10.6 Q1	−5.1	0.72	0.79	1.0	4.72	4.36
Latvia	−7.0 Jul	−6.0 Jul	−22.2	0.51	0.55	nil	10.89	na
Lithuania	−6.5 Jul	−4.3 Jul	−12.9	2.47	2.72	−0.5	5.61	na
Luxembourg	−5.6 Jun	+4.5 Q1	na	0.72	0.79	0.3	4.72	na
New Zealand	−4.4 Jul	−9.3 Q2	−9.8	1.36	1.51	4.9	7.15	6.24
Peru	+8.8 Jul	+2.8 Q2	+1.9	3.13	3.24	0.4	5.00	na
Philippines	−3.4 Jun	+5.7 Mar	+5.1	45.6	50.2	−1.1	6.69	na
Portugal	−23.3 Jun	−18.0 Jun	−8.2	0.72	0.79	−3.3	4.72	4.52
Slovakia	−2.8 Jul	−3.5 May	−4.5	24.2	29.5	−2.9	4.14	4.58
Slovenia	−2.4 Jul	−1.5 Jun	−2.6	0.72	0.79	−1.2	na	na

*Merchandise trade only. †*The Economist* poll. ‡Economist Intelligence Unit forecast. §Dollar-denominated bonds.

Sources: National statistics offices and central banks; Thomson Datastream; Reuters; JPMorgan; Bank Leumi le-Israel; Centre for Monitoring Indian Economy; Danske Bank; Hong Kong Monetary Authority; Standard Bank Group; UBS; Westpac.

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Mortgage debt and GDP

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From The Economist print edition

There is a big variation in the burden of mortgage debt across Europe, according to a report from Morgan Stanley. Switzerland has by some distance the biggest mortgage book relative to its GDP. Britain and Denmark, where house prices have risen rapidly in the past decade, have seen their stock of home loans rise sharply. Indeed, mortgage debt is higher in these countries than in America, when measured against national income. Ireland's mortgage burden is lower, but has nearly doubled since 2002. At the other end of the scale, Italy has a mortgage- debt ratio of less than 20% of GDP. Debt ratios in Germany and France are around half the level in Britain, reflecting lower rates of home ownership.

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Markets

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From The Economist print edition

Markets

	Index Sep 19th	% change on one week	% change on Dec 29th 2006 in local currency	% change on Dec 29th 2006 in $ terms
United States (DJIA)	13,815.6	+3.9	+10.9	+10.9
United States (S&P 500)	1,529.0	+3.9	+7.8	+7.8
United States (NAScomp)	2,666.5	+2.9	+10.4	+10.4
Japan (Nikkei 225)	16,381.5	+3.7	–4.9	–2.5
Japan (Topix)	1,567.6	+2.6	–6.8	–4.4
China (SSEA)	5,662.5	+4.3	+101.1	+109.0
China (SSEB, $ terms)	359.6	+9.7	+166.1	+176.4
Britain (FTSE 100)	6,460.0	+2.4	+3.8	+6.1
Canada (S&P TSX)	13,939.8	+1.3	+8.0	+23.7
Euro area (FTSE Euro 100)	1,374.0	+4.0	+7.5	+13.7
Euro area (DJ STOXX 50)	4,389.3	+4.2	+6.5	+12.8
Austria (ATX)	4,622.0	+3.3	+3.6	+9.6
Belgium (Bel 20)	4,384.7	+3.0	–0.1	+5.8
France (CAC 40)	5,730.8	+4.0	+3.4	+9.5
Germany (DAX)*	7,750.8	+3.7	+17.5	+24.4
Greece (Athex Comp)	4,978.6	+3.2	+13.3	+19.9
Italy (S&P/MIB)	40,294.0	+3.3	–2.8	+2.9
Netherlands (AEX)	543.5	+3.9	+9.7	+16.1
Spain (Madrid SE)	1,591.0	+3.1	+2.3	+8.3
Czech Republic (PX)	1,780.7	+1.4	+12.1	+17.9
Denmark (OMXCB)	471.5	+1.9	+11.2	+17.7
Hungary (BUX)	27,382.2	+1.6	+10.2	+16.6
Norway (OSEAX)	572.7	+3.6	+14.0	+27.1
Poland (WIG)	62,572.6	+5.0	+24.1	+33.5
Russia (RTS, $ terms)	2,015.4	+6.1	+0.3	+4.9
Sweden (Aff.Gen)	381.8	+2.7	+4.5	+8.0
Switzerland (SMI)	9,006.8	+2.5	+2.5	+5.5
Turkey (ISE)	53,884.1	+9.4	+37.7	+58.2
Australia (All Ord.)	6,362.0	+2.0	+12.7	+22.3
Hong Kong (Hang Seng)	25,554.6	+5.1	+28.0	+27.9
India (BSE)	16,322.8	+5.3	+18.4	+30.3
Indonesia (JSX)	2,313.3	+4.7	+28.1	+24.9
Malaysia (KLSE)	1,297.2	+0.9	+18.3	+20.8
Pakistan (KSE)	13,127.6	+2.7	+30.7	+31.3
Singapore (STI)	3,594.4	+2.5	+20.4	+22.5
South Korea (KOSPI)	1,902.7	+4.9	+32.6	+33.1
Taiwan (TWI)	8,926.4	–1.0	+14.1	+12.3
Thailand (SET)	811.8	+1.2	+19.4	+26.0
Argentina (MERV)	2,116.5	+5.4	+1.2	–0.9
Brazil (BVSP)	57,264.0	+6.3	+28.8	+47.4
Chile (IGPA)	14,312.8	+1.1	+15.7	+20.0
Colombia (IGBC)	10,473.4	–1.6	–6.2	+2.2
Mexico (IPC)	30,512.6	+1.5	+15.4	+13.7
Venezuela (IBC)	38,310.6	–2.3	–26.7	+14.2
Egypt (Hermes)	75,129.3	+2.0	+22.6	+24.6
Israel (TA-100)	1,064.0	+3.7	+15.4	+19.7
Saudi Arabia (Tadawul)	7,885.5	+1.0	–0.6	–0.6
South Africa (JSE AS)	29,808.7	+3.8	+19.6	+19.5
Europe (FTSEurofirst 300)	1,549.1	+2.6	+4.4	+10.5
World, dev'd (MSCI)	1,609.9	+3.2	+8.5	+8.5
Emerging markets (MSCI)	1,145.6	+5.1	+25.5	+25.5
World, all (MSCI)	404.5	+3.4	+10.0	+10.0
World bonds (Citigroup)	694.2	–0.8	+5.5	+5.5
EMBI+ (JPMorgan)	422.5	+1.6	+3.7	+3.7
Hedge funds (HFRX)	1,316.6	+0.4	+3.2	+3.2
Volatility, US (VIX)	20.0	25.0	11.6	(levels)
CDSs, Eur (iTRAXX)†	38.1	–27.2	+63.4	+72.9
CDSs, N Am (CDX)†	57.7	–20.3	+72.7	+72.7
Carbon trading (EU ETS) €‡	21.2	+0.7	+16.0	+22.8

*Total return index. †Credit-default swap spreads, basis points.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; JPMorgan Chase; Bank Leumi le-Israel; CBOE; CME; Danske Bank; EEX; HKMA; Markit; Standard Bank Group; UBS; Westpac. ‡New series.

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